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United States

OCTOBER TERM, 1976

No. 76-15

CONTINENTAL T.V., INC., A & G SALES, SYLPAC, INC. and S.A.M. INDUSTRIES, INC., *Petitioners*,

vs.

GTE SYLVANIA INCORPORATED, *Respondent*.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF FOR RESPONDENT GTE SYLVANIA INCORPORATED

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BRIEF FOR RESPONDENT GTE SYLVANIA INCORPORATED

OPINIONS BELOW

The Opinion of the Court of Appeals (No. 71-1705) is reported at 537 F.2d 980 (9th Cir. 1976) and is reprinted in full in Appendix A to the Petition for Writ of Certiorari (Pet. Cert. App. A. 1-114). The verdict of the jury in the District Court in the form of answers to special interrogatories is not reported (A. 497-499).[1] After ren-

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[1] "A" refers to the Joint Appendix; "C.T." refers to the clerk's transcript; "R.T." refers to the trial transcript; "Ex." refers to trial exhibits; and "Pet. Br." refers to the Brief for Petitioners.

dition of the jury verdict and over objection by respondent, the District Court entered Findings of Fact and Conclusions of Law which are not reported (Pet. Cert. App. B. 115-129).

JURISDICTION

The judgment of the Court of Appeals was entered on April 9, 1976. The Petition for Writ of Certiorari was docketed on July 8, 1976 and granted on October 18, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

STATUTES INVOLVED

The pertinent statutory provisions are those set forth at Pet. Cert. App. C. 130-133.

QUESTIONS PRESENTED

At issue is the standard of legality under the Sherman Act to be applied to a vertical distribution practice whereby a manufacturer "franchises" its direct-buying retail dealers with respect to the locations at which the latter are authorized to sell products bearing the manufacturer's trademark. This selective method of distribution—commonly referred to as a locations practice—is typically employed for the purpose of enabling smaller manufacturers to develop a system of loyal and efficient dealers capable of offering effective interbrand competition.

On this appeal respondent seeks affirmance of the Ninth Circuit's holding that Sylvania's locations practice as implemented in Northern California in 1964-1965 is to be evaluated under the rule of reason rather than under a rule of *per se* illegality allegedly mandated by this Court's holding in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967).

Since petitioners' statement of the questions presented is, in respondent's view, inaccurate, we offer the following:

1. Is the legality of a distribution system entailing vertical agreements between a manufacturer with a small market share and its direct-buying retail dealers specifying and restricting the locations from which—but not the territories into which or the customers to whom—the latter are authorized to sell the manufacturer's trademarked products to be adjudged under the rule of reason rather than automatically condemned under a rule of *per se* illegality?

This necessarily presents two subsidiary questions:

a. Should the holding in *Schwinn,* which applied to a contractual closed territorial system precluding intrabrand competition between competing units, be mechanically extended to strike down all vertical restrictions which, like a locations practice, involve a type of post-sale restraint, without regard to the pro-competitive benefits derived from such practices?

b. If the holding in *Schwinn* did establish a *per se* rule applicable to a locations practice, should that holding be reconsidered in light of its questionable jurisprudential underpinnings and its fail-

ure to strike an appropriate balance between the legitimate interests of manufacturers and dealers?

2. Does any rule of *per se* illegality applicable to a locations practice contain an exception when that practice is reasonably necessary to enable the manufacturer to achieve and maintain an effective role as a competitor rather than fail in the relevant industry?

3. May any rule of *per se* illegality derived from *Schwinn* be retroactively applied, consonant with notions of fundamental fairness, to impose treble damages for conduct occurring at least two years prior to the *Schwinn* decision?

STATEMENT OF THE CASE

A. Economic Background.

Sylvania's locations practice was conceived and implemented as a competitive response to an increasingly poor market position. Sylvania was one of the brands to emerge in the television industry following World War II.[2] With black and white as the major product line, RCA established itself as the industry leader with as much as 60-70 percent of a market featuring some 131 manufacturers (R.T. 2766-2768, 2771; A. 382-386). Sylvania, together with Dumont, Stromberg-Carlson, Olympia and other lines, managed to capture only a small portion of the market (R.T. 2770; A. 385).

In the black and white era, most manufacturers utilized a "saturation" type of distribution (R.T. 2767-2770, 2773-2774; A. 382-388). This involved the sale of products to independent or company-owned distributorships who resold to retailers. In the late 1950's, however, Magnavox pioneered a limited or "selective" distribution system the thrust of which was to eliminate the middleman-tier between manufacturer and retailer and to develop its interbrand competitive position by the careful screening of its authorized retailers (C.T. 2774-2775; A. 387-389).

By 1960 Sylvania's market position had deteriorated markedly. Its attempt to maintain a saturation-type distribution policy in competition with RCA, Zenith and others was wholly unsuccessful. (See, *e.g.*, R.T. 2771-2772; A. 385-387.) Sylvania's market share was a dismal 1 to 2 percent—well below the level considered necessary to sustain profitable operations in light of the high costs associated with television production and distribution (R.T. 591; A. 179-180). With the advent of color and the concomitant increase in production and distribution costs, Sylvania was confronted with the stark choice of either improving its competitive position through a different distribution technique or going out of the television business. The uncontradicted testimony of Ray J. Steiner, Vice-President of the Sony Corporation of America and former National Sales Manager of Sylvania, describes Sylvania's market dilemma: while the corporation was not in financial difficulty considered as a whole,

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[2]The text portrait of the television industry derives principally from the testimony of William E. Boss, Vice-President of Marketing of Sylvania's Home Entertainment Products Division (R.T. 2761-2813; A. 379-401). Mr. Boss, who was Chairman of the Board of the Consumers Electronic Group of the Electronic Industries Association, testified on the basis of some 15 years' experience with RCA, followed by 2 years each with Admiral and Motorola preceding his employment by Sylvania in 1967.

there was grave doubt about its ability to compete in the television market and consequent concern about the wisdom of committing its economic resources to that endeavor. As Mr. Steiner testified:

> "Q. To your knowledge, sir, did the sales branch of Sylvania consider any economic alternatives back in 1962, '63?
>
> "A. Yes.
>
> "We knew that if the advent of this program, if it didn't work and we didn't increase our market penetration, if we didn't keep our plant running in Batavia, there was the alternative that we would probably go out of the television business." (R.T. 2544; A. 365-366).[3]

[3]Additional evidence of the failing character of Sylvania's television business appears in the testimony of Donald Carroll, Regional Sales Manager for Sylvania's Northern California region who, when asked to describe the market conditions in which Sylvania found itself in about 1962, testified:

> "A. In that type of distribution you had most of the suppliers in the United States and two were notably successful, RCA and Zenith, and then the Motorola, the Philco, the Admirals, the Olympics, the Sylvanias, General Electric, Westinghouse, etcetera, were actually floundering and Sylvania especially was floundering to a point where the management decided either they had to come up with a more meaningful form of distribution for their product or cease being a supplier of television and stereo.
>
> "Q. You mean simply go out of business?
>
> "A. Go out of that particular part of the business.
>
> "Q. Sylvania, of course, manufactures other products?
>
> "A. Correct.
>
> "Q. Like flashbulbs—
>
> "A. Light bulbs.
>
> "Q. Light bulbs. I'm not sure what else, but that was the issue as you understood it based on your conversations with the manufacturer?
>
> "A. That is correct." (R.T. 590; A. 179).

See also testimony of John T. Morgan, former President of Sylvania Entertainment Products Corporation, (R.T. 406; 439-440; A. 131-2) and the testimony of William E. Boss (R.T. 2776; A. 389-390).

B. Adoption of the Locations Practice.

To tackle the problem Sylvania engaged a new executive team headed initially by Robert Theis, later assisted by John T. Morgan. Both had formerly been employed by Philco and were thus familiar with the distribution practices in the industry. After careful study Sylvania's management concluded that there was room for Sylvania as a competitor in the growing color market if it could develop a prestige image and attract a group of dealers with sufficient loyalty to "push" the product (R.T. 439-440; A. 131-132). The market goal was to "become another Magnavox"—to increase Sylvania's market share from the 1 or 2 percent level to a sustainable and profitable level in excess of 5 percent (R.T. 594-596; A. 182-183). Thus the key notion underlying Sylvania's market decisions in the critical 1961-1962 period was the intent to make Sylvania, in conjunction with its dealers, a more effective competitor of RCA, Zenith and other major brands (R.T. 2773-2781; A. 386-394).

Sylvania's solution, ultimately called its "elbow room policy", was the adoption of a technique of limited rather than "saturation" distribution designed to attract select retailers willing to hold themselves out as authorized Sylvania dealers (R.T. 2776-2779; A. 389-392). Following the Magnavox lead, Sylvania altered its distribution system in major metropolitan markets by phasing out most of its wholesale distributors as well as its factory owned distributorships in favor of direct factory-retailer distribution. As a consequence, inventory availability and credit extension became Sylvania's direct responsibility as did selection of retailers based upon their perceived attitude

and potential. Pursuant to this new approach, Sylvania attempted to "franchise" only dealers who were willing to invest in high-grade facilities, carry a representative line, provide customers with a full range of services and engage in extensive advertising and in-depth market coverage in their particular locale (R.T. 2543-2550; A. 365-370).

C. The Locations Practice in Operation.

The new distribution system involved execution of a franchise agreement between Sylvania and each retailer terminable by either party upon ten days written notice to the other (Ex. 3; A. 18-22). While not specified in the written terms, the franchise agreement was understood as applying only to such locations as were mutually agreeable.[4] Sylvania reserved to itself the right to determine whether it would sell to a particular retailer for resale as an authorized Sylvania dealer at a designated location (R.T. 2778; A. 391). This was true whether or not a particular dealer was authorized to sell Sylvania products at one or more other locations. Put simply, a dealer authorized *somewhere* as a Sylvania franchisee was not authorized *everywhere;* Sylvania did not franchise chains as such (R.T. 420-1; A. 123-125).

The policies employed in implementing Sylvania's locations practice included the following:

[4]The initial location was normally noted on Sylvania's dealer information form transmitted by Sylvania's district salesmen to its headquarters at Batavia, New York. When Sylvania agreed to franchise subsequent or branch locations, the dealer was orally advised by his salesman and the action was recorded in appropriate account sheets at headquarters. (See, *e.g.*, R.T. 420, 500-504; A. 123-124, 150-154.)

1. No retailer had the right to veto Sylvania's decision to franchise another location in a particular market area. Sylvania made its determination to franchise or not with reference to such factors as market penetration and quality of the prospective dealer, but without prior approval by any existing authorized retailer. (See, *e.g.*, R.T. 446-7; 2550-1; A. 136-137; 369-371.)

2. While the purpose of the policy was to "space" dealer locations, Sylvania at no time entered into any agreements or understandings restricting the freedom of an authorized Sylvania dealer operating from a franchised location to sell to anyone wherever situated. (See, *e.g.*, R.T. 645, 2550; A. 193-194, 370.)

3. Sylvania encouraged its authorized dealers to handle competing lines, including RCA, Zenith, Philco and other major brands, and entered into no understandings or agreements limiting a dealer's independent choice with respect thereto (R.T. 2550; A. 370).

4. Sylvania did not engage in any understandings or agreements whereby a particular dealer was afforded an "exclusive"; at all times Sylvania reserved the right to authorize a Sylvania dealer to function in an area in competition with an existing dealer. (See, *e.g.*, R.T. 432; A. 126-7.)

5. While Sylvania did not extract promises from its dealers not to sell from unauthorized locations, such sales activity was plainly contrary to the "sense" of the distribution system. We here take it as established that Sylvania's locations practice as it func-

tioned in Northern California in 1964-1965 involved an implied agreement between Sylvania and its dealers to the effect that dealers would not move inventory owned by them to unfranchised locations for resale without Sylvania's approval.[5]

D. Competitive Effects of the Locations Practice.

Sylvania's new distribution technique proved successful (R.T. 589-596, 2554; A. 178-183, 372). From 1962 to 1965 RCA and Zenith maintained their leadership positions while other manufacturers fell by the wayside. But Sylvania was able to attract aggressive dealers, improve its product image and expand its market share to approximately 5 to 6 percent nationally (R.T. 651; 2770-2779; 2878-2879; A. 198, 385-392, 405-406). It thus emerged as a viable competitor, ranking approximately eighth or ninth in the country with a modest but sustaining market position. In the opinion of its marketing personnel, Sylvania's revival as an interbrand competitive factor was a direct result of its locations practice (R.T. 651; 2554; A. 191-192, 372).

Sylvania's success was particularly striking in the greater Sacramento area where its market share exceeded

[5]At trial Sylvania contended that its locations practice involved no agreement—be it express or implied—with its franchised dealers with respect to the movement of inventory. It was Sylvania's position that it conceived and implemented its distribution practice unilaterally as an announcement upon which its distribution system was based and not as part of any "contract, combination or conspiracy." (See *United States v. Colgate & Co.*, 250 U.S. 300 (1919).) However, on appeal Sylvania defers to the findings of the jury and assumes that its locations practice did involve a "combination" or "conspiracy" within the expanded scope of those concepts as articulated in such cases as *Albrecht v. The Herald Co.*, 390 U.S. 145 (1968), and thus went beyond the unilateral in the respects noted in text.

13 percent in 1965 (R.T. 635; A. 186). While one retail dealer, Handy Andy, enjoyed the largest share of the Sacramento area business, other franchised dealers operating both within the City of Sacramento itself (a branch of the Sherman Clay chain) as well as from locations in suburban Roseville and Woodland—locations well within the 25-50 mile radius of practical marketing—guaranteed effective competition in the Sylvania product line in the Sacramento market area (Ex. 70; R.T. 526-532, 1113-1117; A. 163-168).[6]

Indeed, during 1964-1965 Sylvania's locations practice resulted in fewer but more select dealers competing in Northern California with at least two or more such authorized dealers serving every metropolitan market larger than 100,000 in population.[7] In all Northern California areas there were a large number of dealer outlets and available brands.[8] Sylvania's locations practice thus imposed no meaningful restriction on customer choice and did not deny other manufacturers access to retail out-

[6]Petitioners' repeated assertion—complete with foldout chart—that Handy Andy was "given" the "entire Sylvania market" in the Sacramento area (Pet. Br. 8-9, 35, 38) is simply argumentative hyperbole.

[7]Both at trial and now in their Brief (Pet. Br. 6-7) petitioners cleave to a phrase in an early intra-company manual for salesmen which stated that Sylvania's distribution policy "eliminates 'same brand competition'." But as all of the witnesses recognized, this language was essentially inaccurate in view of the fact that Sylvania's locations practice—while concededly limiting intrabrand competition—was never applied in Northern California in such a way as to prohibit such competition. (See, *e.g.*, R.T. 468-473, 646-647; A. 141-145, 194-195.)

[8]For example, in Sacramento in 1965, there were approximately 100 retail dealers (R.T. 1183; A. 285), and there were approximately 25 brands on the market.

lets.[9] Nor did it have any adverse impact on output or prices. From 1962 forward, there was a steady increase in product volume and decrease in price both for Sylvania brand merchandise and in the television market in general (R.T. 2785-2787; A. 394-396).

Based on these facts, a prominent economist, Professor Lee Preston, Jr. (formerly a member of the Neal Task Force on Antitrust Policy under President Johnson and a consultant to the Department of Justice and Federal Trade Commission) testified as to the competitive effects of a television manufacturer, such as Sylvania, employing a selective distribution policy including restrictions on the locations of dealers. His opinion was that such a practice "has no effect on the strength of competition in the market as a whole because there are so many outlets, so many competitive alternatives throughout the market." (R.T. 2885; A. 411). He further testified:

> "The particular choice of a dealer by a manufacturer is no more an element in determining the strength of competition than, for example, the consumer's choice of one product over another. It is the consumer's ability to choose that is competitive." (R.T. 2886; A. 412).
>
> * * * * *
>
> "Therefore, if this distribution policy or any particular distribution policy has the effect of strengthening Sylvania or any other smaller firm as a competitive force among the other firms in that market, many of which are larger, then I think we

[9]Customer choice was enhanced by the fact that neither Sylvania nor most other manufacturers attempted to restrict the brands that dealers handled, and most dealers handled more than one brand.

> have to look carefully at that policy as an element in competition, indeed as a pro-competitive policy among the brands and the manufacturers as a whole." (R.T. 2888; A. 413).

Professor Preston concluded that there were no anticompetitive characteristics in such a distribution practice.[10]

E. The Sylvania-Continental Business Relationship.

Petitioner Continental T. V., Inc. became a Sylvania dealer in May 1964 at which time it was franchised to sell Sylvania products at stores located in San Leandro and San Jose. It then and subsequently utilized a "promotional" method of selling which featured home demonstrations based on telephone contacts with prospective customers (R.T. 352-354; A. 113-115). As a consequence it was able to make sales at distances 25 to 50 miles and beyond from its store locations with some frequency (R.T. 1599-1603; A. 335-337). It also managed to charge some $50 to $100 per set above Sylvania's suggested resale prices (R.T. 1595-1597; A. 332-333).

Continental's initial orders were purchased from Sylvania on open account. But in July 1964 Continental

[10]While Professor Preston's opinion was subjected to the usual form of cross-examination, it remained unaltered. Contrary to petitioners' assertion at Pet. Br. 53, he "backed away" not at all. (See R.T. 2968-2969; A. 472-473.) While colloquy between bench and bar early in the trial suggested that the trial court might be disposed to instruct the jury that a locations practice was illegal *per se* (R.T. 609-633), the trial court nevertheless permitted Sylvania to offer such evidence concerning the purpose and effect of its locations practice as Sylvania believed sufficient to present its rule of reason defense. Continental had the opportunity to rebut that evidence but elected to stand upon its *per se* contentions. It thus offered no evidence—expert or otherwise—concerning whether a practice which limits the number of dealers carrying a particular brand has an adverse effect upon competition.

commenced financing purchases on the "Maguire Plan" pursuant to which Continental executed a promissory note for the price of each item secured by a trust receipt in favor of John P. Maguire & Co., Inc. ("Maguire"). Under this arrangement Continental was obligated to pay Maguire the price of each item immediately upon its sale by Continental except that for every item remaining unsold as of six months after the trust receipt and invoice date ("maturing items") payment was due and owing at the end of such six-month period. By virtue of the contractual relationships between Maguire and Sylvania, Maguire had full recourse against Sylvania for all sums advanced to dealers to finance purchases of Sylvania products. Consequently, Sylvania alone made all decisions concerning the amount of credit to be extended and whether additional credit would be extended at all (R.T. 2985-2988; A. 474-476).

By May 1965, Continental and its affiliates[11] were operating in some eight franchised locations in Santa Clara, San Mateo, Alameda and San Francisco counties. Aside from the San Jose store and warehouse facility in Santa Clara County, these locations were operated under short-term leases which required little capital investment while affording maximum flexibility and mobility in opening up and closing down (R.T. 1578-1580; A. 331-332).

[11]The affiliates are A & G Sales, a corporation; Sylpac, Inc., a corporation, and S.A.M. Industries, Inc., a corporation. The principal owner of all entities is George N. Shahood. All entities did business under the trade style "Continental T. V." and were treated by all concerned, both during the course of dealing and in litigation, as a single enterprise. (See discussion in the Opinion below, Pet. Cert. App. A. 41, fn. 30.) They are collectively referred to hereinafter as "Continental".

By May 1965, too, Continental had become one of the largest Sylvania dealers in the United States, with sales volume in excess of one million dollars on an annual basis. That volume was perceived by Continental's principal, George N. Shahood, as endowing Continental with sufficient market power in Northern California to justify a voice in and veto over Sylvania's decision with respect to whether it might franchise dealers proximate to Continental's locations. Thus in the spring of 1965 Continental objected to Sylvania's plans to franchise Young Bros., a retailer operating a facility in San Francisco relatively near Continental's Geary Street location, and threatened to cut down its volume of Sylvania purchases if such a franchise were granted (R.T. 1612-1623; A. 338-346).[12] When in June 1965, Sylvania advised Continental that it nonetheless intended to franchise Young Bros. in San Francisco, Mr. Shahood tore up a large Sylvania order, stormed out of a sales convention, placed a half million dollar order with Philco and advised Sylvania that Continental would indeed cut back its Sylvania purchases and sales (R.T. 656-669; A. 199-208).

Fundamental to Continental's meteoric expansion in location and volume as a Sylvania dealer was Sylvania's willingness to extend credit. However, in the spring of 1965, contemporaneous with the developing Young Bros. incident, Sylvania's credit department began to have seri-

[12]Sylvania's market share in San Francisco approximated 2.5 percent (R.T. 635; A. 186)—half its national and Northern California average—thus indicating to Sylvania the desirability of franchising additional dealers in that city (R.T. 665-669; A. 205-208). Precisely the opposite situation existed in Sacramento where Sylvania's market share exceeded 13 percent (R.T. 533-537; A. 186).

ous difficulties with Continental over late payments for merchandise and other matters relating to the financing arrangements. Although these problems appeared to have been resolved by discussions in June 1965 (R.T. 3152-3155), credit and payment difficulties worsened during the ensuing three months. Moreover, the credit implications of Continental's half million dollar order with Philco caused Sylvania's credit personnel concern over the continuation of Continental's very high ($300,000) credit line with Sylvania (R.T. 1050-1051).[13] In July, August and September 1965, Continental consistently made late payments for merchandise sold, and in September 1965 there appeared to be a tremendous increase in the floored merchandise which was unsold and on which obligations were passing into maturity and then into the delinquency stage (R.T. 783-791, 1077-1078; Exs. 51-66, 79; A. 215-223). Inexplicably, Continental also suspended all "renewal" or interest payments on its financing obligations (R.T. 790; A. 221).

To cap matters, in late August 1965, Sylvania's credit personnel at corporation headquarters—as distinct from those in the field (see Pet. Br. 15-16, fn. 5)—learned for the first time, from a Dun & Bradstreet report, that Mr. Shahood previously had been convicted of three offenses involving the writing of bad checks and misappropriation of government funds (R.T. 3156-3158; Exs. DY and DZ). As a consequence, in late August or early September, Sylvania's credit department placed a credit hold

[13]This concern was realized in September-October 1965 when Continental suspended payment for Sylvania merchandise but continued remittances to Philco.

on Continental's orders, and on September 16, 1965, reduced Continental's credit limit of $300,000 to $50,000 (R.T. 3015-3022).

While this crisis in credit relationships was developing, Continental advised Sylvania that it proposed to open a new store at a location in Sacramento. As described prior to August 1965, Continental planned to feature Philco merchandise at the Sacramento facility (R.T. 250-252, 533-537, 1626-7; A. 66-7, 168-171, 347-348). However, over the Labor Day weekend preceding September 5, 1965, Continental abruptly changed its plans and advised Sylvania that it was in the process of moving Sylvania merchandise from its warehouse to the Sacramento facility (R.T. 264, 1626-1627; A. 72-73, 347-348). Continental coupled the movement with a demand to Sylvania's salesman in the Santa Clara County area for the immediate grant of a franchise for the new store. (See R.T. 264-5, 271-3; A. 72-73, 77-79.) When the franchise was not forthcoming, Continental decided to keep the Sylvania merchandise in the Sacramento store (R.T. 1531-1535; A. 315-318).

There was evidence that the "Sacramento move" by Continental was motivated by the desire to retaliate against Sylvania for its decision to franchise Young Bros. in San Francisco and to force a reconsideration of that decision. (See R.T. 1626-32; A. 347-353.) But whether the motive was retaliation, market "skimming" or something else, the "Sacramento move" disturbed Sylvania's sales personnel, both because of the procedure followed (R.T. 2569-2571) and because of the belief held by some that Sylvania's market penetration in the Sacra-

mento area already exceeded reasonable expectations and that other Sylvania outlets there were unnecessary or undesirable (R.T. 533-541; A. 168-173).[14] Price played no part in these judgments particularly since, as previously noted, Continental generally sold at prices above Sylvania's suggested retail.

Since the credit cut described above followed the "Sacramento move" by approximately two weeks, Continental took the position that it derived, not from legitimate credit or payment concerns, but rather from a "scheme" by Sylvania to restrict Continental to its authorized locations well removed from Sacramento. Reacting to the credit cut and its deteriorating relations with

[14]Mr. Morgan testified that he talked to Mr. Keith Anderson, the principal of Handy Andy, after Continental made its "Sacramento move", as follows:

"Q. That was all that was said, Continental is here and they got merchandise, something to that effect?

"A. Right. Right. And we talked about some models and some styling, and he mentioned it, and I says, 'Keith, I don't want to talk about it.' I didn't talk about it."

* * * * *

"Q. All right. Now during the conversation with Anderson on the phone, did he make any complaint at all about Continental being at Sacramento?

"A. No, other than telling me that he is selling merchandise down there, and that's it.

"Q. He wasn't happy about it, was he?

"A. No, he wasn't happy about it, but he didn't threaten me or anything else. He just told me Continental opened up down there." (R.T. 430-431; A. 129-130).

This communication between Mr. Morgan and Mr. Anderson provides no evidentiary basis for petitioners' repeated assertion that Sylvania terminated Continental at the "instigation of its protected dealer, Handy Andy" (Pet. Br. 25) rather than as a result of Sylvania's own view of its self-interest—a view unquestionably influenced by the presence of Handy Andy as a valued customer in the Sacramento area. Be that as it may, the question presented concerning the standard of legality applicable to Sylvania's locations practice is unaffected by this incident. See discussion *infra*, at 40 n. 31.

Sylvania, Continental withheld all payments owing to Maguire for Sylvania merchandise (R.T. 1549-1551). This refusal to make payment persisted for over three weeks until at least $62,000 under Continental's own computation was due and owing, unsecured by any merchandise (R.T. 790-791; A. 221-222). At this point, on October 12, 1965, Maguire filed this action to collect the amounts due (including indebtedness accelerated because of the payment default). On the same date Sylvania notified Continental that its franchise as a Sylvania dealer was terminated (Ex. FB).

F. Proceedings in the Trial Court.

As noted above, this action commenced on October 12, 1965, when Maguire filed suit against Continental (C.T. 1). Since some of the promissory notes upon which suit was premised were secured by goods still in Continental's possession, claim and delivery proceedings were also instituted whereby Maguire repossessed and sold such merchandise pursuant to Uniform Commercial Code procedure. Attachments were attempted to secure the balance of the debt but proved unsuccessful because Continental had withdrawn all funds in its checking accounts in anticipation of the litigation (R.T. 1552-1553).

Continental answered, counterclaimed and crossclaimed on November 22, 1965 (C.T. 37). While denying that Maguire was entitled to judgment on its complaint for various reasons, Continental sought damages against both Sylvania and Maguire for alleged violations of the antitrust laws and for tortious injury to its business and property under California law. Issue was fully joined by

Maguire's Reply to the Counterclaim filed January 25, 1966 (C.T. 60) and the Sylvania-Maguire Answer to Cross-claim filed April 22, 1966 (C.T. 162).

After amendment of the pleadings following completion of discovery,[15] trial by jury was held before Justice Tom C. Clark, sitting by designation as United States District Judge.

G. The Jury Instructions.

At trial Continental claimed that the damages it had suffered during a period of product shortage following the rupture of relations with Sylvania had been proximately caused by Sylvania's adoption and enforcement of its locations practice. Although Sylvania contended otherwise, it also argued that if the legality of that practice were dispositive then the practice itself was lawful, or, in all events, should be evaluated under the rule of reason. The District Court rejected Sylvania's submission in favor of a *per se* rule: it specifically charged the jury that any effort by Sylvania "to restrict outlets or store locations from which its dealers resold the merchandise which they had purchased from Sylvania" would be a violation of the antitrust laws "regardless of the reasonableness of the location restrictions." The critical instruction which, as the majority opinion below observes, "virtually assured" a verdict against Sylvania (Pet. Cert. App. A. 15), was as follows:

> "Therefore, if you find by a preponderance of the evidence that Sylvania entered into a contract, combination or conspiracy with one or more of its dealers pursuant to which Sylvania exercised dominion or control over the products sold to the dealer, after having parted with title and risk to the products, you must find any effort thereafter to restrict outlets or store locations from which its dealers resold the merchandise which they had purchased from Sylvania to be a violation of Section 1 of the Sherman Act, regardless of the reasonableness of the location restrictions." (R.T. 3447; A. 492).[16]

[15]Maguire's Amended Complaint appears at C.T. 689. Damages are therein sought for the total sum of $81,000 following a stipulation that this sum represents the aggregate amount advanced by Maguire to Continental for merchandise sold to Continental by Sylvania which had not been paid through court process or otherwise (C.T. 694). The amount was less than that originally prayed principally because of the credits derived from the repossessed merchandise (compare Pet. Br. 3, fn. 2). The Second Amended Cross-claim appears at C.T. 703. This pleading, like its predecessors, includes as its Fourth Cause claims for breach of contract against Sylvania and Maguire for alleged failure to supply or failure to finance certain merchandise ordered by Continental in August-September 1965. The breach of contract claim was ultimately withdrawn. The Answer to the Second Amended Cross-claim appears at C.T. 744.

[16]The Court rejected instructions proffered by Sylvania under which the jury would have been instructed that the challenged practice (if implemented by "contract or conspiracy") may be held illegal if it unreasonably restrained or suppressed competition in the relevant markets for television products. See Sylvania and Maguire's requested jury instructions Nos. 29 (C.T. 1157-8; A. 5-6), 31 (Revised) (C.T. 1161-1164; A. 9-12), 31c (C.T. 1270-1; A. 12-14) and 31d (C.T. 1272; A. 14-15). Petitioners criticize the language of these instructions (Pet. Br. 21, fn. 7) but we need not burden this Court with arguments on the subject since it is well settled that it is the duty of the trial court to instruct the jurors fully and correctly on the applicable law—a duty in nowise affected by any technical defects in a party's request to charge particularly when, as here, an entire theory of legality is at stake. (See, *e.g.*, *Lind v. Aetna Casualty and Surety Co.*, 374 F.2d 377 (5th Cir. 1967); *Marshal v. Isthmian Lines, Inc.*, 334 F.2d 131 (5th Cir. 1964); 2B Barron & Holtzoff, *Federal Practice and Procedure*, §1102, pp. 447-448.) Similarly, the effect of the *per se* instruction cannot be cured "by a prior unexceptional and unilluminating abstract charge" of the kind given here. *Bollenbach v. United States*, 326 U.S. 607, 612 (1946). See also *DeLima v. Trinidad Corp.*, 302 F.2d 585 (2d Cir. 1962); *Callen v. Pennsylvania Railway Co.*, 162 F.2d 832 (3d Cir. 1947), *aff'd*, 332 U.S. 625

On November 6, 1970, the jury returned its verdict in the form of answers to special interrogatories (C.T. 1304-1306; A. 497-499). The jury found that Sylvania engaged "in a contract, combination or conspiracy in restraint of trade in violation of the antitrust laws with respect to location restrictions alone" and that Continental sustained damage as a proximate result thereof in the sum of $591,505.[17] However, Sylvania prevailed against the claim that its locations practice was coupled with unlawful price fixing.[18] The jury also found that

(1948). With all respect to the trial court, the charge to the jury given here can only be described as confusing except insofar as it (1) precludes a rule of reason evaluation of Sylvania locations practice (if that practice be found to be concerted in character) and (2) reflects rejection of Sylvania's "failing company" and retroactivity defenses. It was, of course, the ambiguities of the charge which shaped final arguments to the jury. Compare the misunderstanding of those arguments in Judge Kilkenny's dissent below (Pet. Cert. App. A. 58-60) with the correct reading of the majority (Pet. Cert. App. A. 14-16).

[17]The court instructed the jury that in order to find that a locations restriction proximately caused the damage claimed, that restriction need play only "a substantial part" in bringing about the damage, even though other legitimate conduct or purposes (such as credit decisions) might have also contributed to such damage (R.T. 3449). In view of the answers to the interrogatories respecting Maguire and the California tort claims, it seems plain that the jury found that, while attempted enforcement of its locations policies may have been one reason for Sylvania's conduct *vis-a-vis* Continental in September and October 1965, it was scarcely the primary motivating factor. Sylvania has made no claim of error with respect to the trial court's instructions or the jury's findings as respects proximate cause or damage issues.

[18]The use of separate interrogatories makes it plain that Continental's price fixing charge upon which it lost was distinct and severable from the vertical locations practice charge upon which it prevailed under *per se* instructions. Continental has had its day in court on its price fixing claims and ought not to be entitled to another in the event that the Ninth Circuit judgment be affirmed and the case remanded for retrial. See, *e.g., Gasoline Products Co. v. Champlin Refining Co.*, 283 U.S. 494 (1931). See also *Mack Trucks, Inc. v. Arrow Aluminum Castings Co.*, 510 F.2d 1029 (5th Cir. 1975); *Williams v. Slade*, 431 F.2d 605 (5th

Sylvania did not willfully or maliciously cause injury to Continental's business in violation of California law. Finally, Maguire was exonerated against all claims.

H. Findings and Judgment.

Following the jury verdicts Continental moved for entry of findings of fact and conclusions of law respecting its equitable prayer for an injunction (C.T. 1322). Continental's entitlement to such relief as well as its proposed findings were contested (see C.T. 1352, 1379, 1394) but the trial court ultimately resolved to enter a limited injunction premised solely upon the *per se* theory of its jury instructions. Findings and conclusions were thereupon entered in accordance with that determination (C.T. 1421-1434; Pet. Cert. App. B. 115-129).[19]

Cir. 1970); *Yates v. Dann*, 11 F.R.D. 386 (D. Del. 1951). In the Conclusion, *infra*, Sylvania proposes that any new trial be expressly limited to petitioners' locations practice claim under rule of reason standards thereby obviating any post-remand question respecting this matter.

[19]The critical conclusions of law are the following:

"3. Sylvania, during the time involved herein, and in violation of Section 1 of the Sherman Act, did engage in a contract, combination or conspiracy with its retail dealers, including Handy Andy and Continental, pursuant to which it restricted and enforced its location distribution policy and imposed a system of location restraints upon its retail dealers limiting for all practical purposes the areas in which they could display and sell Sylvania brand products which the dealers had purchased from Sylvania and which were owned by them.

"4. As a proximate result of Sylvania's conduct as above described, Continental sustained damage to its business and property as found by the jury. Moreover, equitable relief having been granted in the Judgment heretofore entered on the 11th day of December, 1970, the Court deems it necessary to enter in support thereof, the Findings of Fact and Conclusions of Law contained herein.

"5. The foregoing restraints are *per se* violations of Section 1 of the Sherman Act, inasmuch as Sylvania made sales

Concurrent with the proceedings on the injunction Maguire moved for summary judgment on its Amended Complaint (C.T. 1318). By stipulation of the parties the Maguire motion was granted in the sum of $145,000 as principal, prejudgment interest, costs and attorneys' fees. In addition to this award to Maguire, the Judgment duly filed December 11, 1970 awards Continental the sum of $1,774,515, being the verdict of the jury trebled, plus costs in the sum of $18,000 and an attorney's fee in the sum of $275,000 (C.T. 1366-1371; A. 500-505). On March 2, 1971, Sylvania filed its notice of appeal from those portions of the judgment below which awarded monetary and injunctive relief to Continental T. V. (C.T. 1437-1438; A. 506-507).

I. Ninth Circuit Proceedings.

By a 7-4 majority the Court of Appeals for the Ninth Circuit reversed the District Court's judgment and equitable decree and ordered the action remanded for a new trial.[20] The majority concluded that Sylvania's locations practice was factually distinguishable from the restrictions condemned in *Schwinn* and, therefore, that the District Court erred in applying a *per se* rule derived from

to its retailers upon 'condition, agreement or understanding limiting the retailers' freedom as to where and to whom it will resell the products', these sales having been made 'subject to territorial restrictions upon resale'. *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 378-379 (1967)." (C.T. 1432-1433).

[20]A panel of the Ninth Circuit had previously affirmed the District Court's judgment by a 2-1 majority in an unreported opinion dated May 9, 1974. That opinion was withdrawn when the Court of Appeals agreed to rehear the case *en banc*.

Schwinn to Sylvania's practice.[21] In reaching this conclusion the majority stressed the established rule that opinions in Sherman Act cases must be read with regard to their particular facts. The Court noted also the absence of any reported decision wherein a locations practice had been held unlawful. By way of contrast, the majority viewed the many cases upholding a manufacturer's right to grant "exclusive dealerships" as persuasive authority supporting a rule of reason inquiry. In its view the antitrust laws were not intended to proscribe practices such as Sylvania's which might promote rather than impede competition. It concluded that Sylvania's locations practice ought to be evaluated by the trier of fact under appropriate rule of reason instructions.

SUMMARY OF THE ARGUMENT

I.

The trial court refused to permit a rule of reason evaluation of Sylvania's locations practice because of its view that this Court's holding in *Schwinn* required *per se* interdiction. The Ninth Circuit rejected that view and for good reason: Sylvania's locations practice differs in both form and effect from the restraints held illegal *per se* in

[21]In light of its holding the Ninth Circuit majority considered it unnecessary to address Sylvania's additional assignments of error, namely, (1) that even if Sylvania's locations practice could be held illegal *per se* under *Schwinn*, Sylvania was wrongfully denied the benefit of, and jury instructions respecting, its "failing company" defense; and (2) that even if this Court's 1967 opinion in *Schwinn* renders a locations practice illegal *per se*, that rule should not be applied retroactively to Sylvania's 1964-1965 conduct.

Schwinn. No purchaser from Sylvania was restricted or confined to a particular territory into which he could sell or deliver Sylvania products; nor was he subject to any restraint upon the customers to whom he might resell. The only restriction was upon the locations at which the purchaser/retailer was franchised. While in theory authorized locations might be so spaced as to preclude effective competition between franchises, there is no showing that any locations practice—be it Sylvania's or some other—has ever been so implemented. Indeed, Sylvania franchised multiple dealers in all relevant market areas including Sacramento. Consumers thus enjoyed a meaningful intrabrand choice as well as the benefits of active interbrand competition.

Reasoned antitrust policy ought to demand that a practice not be categorically rejected as unreasonable simply because of its effects upon one aspect of competition when there is compelling evidence of benefit overall. Such compelling evidence there plainly is: possessing but a small share of the market, Sylvania turned to its locations practice as the singular means for its survival as an interbrand competitive factor in the television market. The interbrand competitive benefits which accrue from the preservation of Sylvania as a viable competitor plainly offset any adverse effects upon intrabrand competition which might result from a diminution in the number of competing dealers handling the Sylvania line. Thus, the Ninth Circuit correctly joined all other courts in holding that a locations practice can be held illegal only after a rule of reason trial in which its competitive purposes and effects are fairly evaluated.

II.

If the holding in *Schwinn* did establish a *per se* rule of such breadth as to invalidate a locations practice, then that holding ought to be reconsidered. On its face the *Schwinn* rule appears questionable because it attaches decisive antitrust consequences to a seeming irrelevancy —the passage of title and risk. In our view, however, the problem runs deeper: the line drawn in *Schwinn* between pre- and post-sale restraints reflects the erroneous assumption that sound antitrust policy ought to give priority to a buyer/dealer's "economic freedom" at the expense of all other antitrust concerns including those of the manufacturer.

In the field of vertical restraints rules ought to be fashioned which further competition while accommodating the interests of manufacturers, distributors and consumers alike. When expansively read the *per se* language in *Schwinn* fails of this goal. Once a manufacturer has made its decision to sell to a dealer, the *per se* language would strip the manufacturer of its "economic freedom" to terminate relationships in the event the dealer were to alter its place of business—whether or not such alteration might adversely impact the legitimate interests of the manufacturer or other dealers in the distribution system. Moreover, an expansive *per se* rule has consequences which appear to be unduly restrictive with respect to interbrand competitive interests and dubious in value from the perspective of intrabrand competition. All competing interests can be fairly balanced under the rule of reason including those which relate to preservation of meaningful intrabrand competition.

Nor is such a result inconsistent with prior authorities invalidating vertical price fixing. As Justice Brennan pointed out in his separate opinion in *White Motor,* restricting dealer discretion with respect to price inhibits the ability of dealers to respond to interbrand competitive conditions as well as intrabrand. Vertical restraints affecting territory have no such dimension.

III.

The uncontradicted evidence established that Sylvania was a "failing company" in the television business when it conceived and implemented its locations practice. Such a showing of economic necessity premised upon imminent business failure establishes a recognized justification for conduct otherwise deemed anticompetitive. Even assuming that a *Schwinn per se* rule was applicable to Sylvania's locations practice, the trial court committed prejudicial error in declining to submit the issue to the jury.

IV.

If this Court were to hold that the *per se* language of *Schwinn* strikes down a locations practice, that holding should not be applied to Sylvania's conduct involving, as it does, events occurring over two years prior to *Schwinn. Schwinn* plainly established a new principle of law. While vertical closed territorial systems had been subject to attack prior to *Schwinn,* courts had uniformly upheld all other vertical distribution restraints including locations practices in situations where neither the manufacturer nor dealer dominated the market. *Schwinn's per se* lan-

guage was both unanticipated and, in the language of Justice Stewart, "a radical change in the law." 388 U.S. at 389. Under the applicable authorities, including *Chevron Oil v. Huson,* 404 U.S. 97 (1971), Sylvania is reasonably presumed to have relied upon the law as it was when it acted. No antitrust policy would be served by penalizing its conduct by the award of a treble damage windfall to petitioners.

ARGUMENT

I.

SYLVANIA'S LOCATIONS PRACTICE SHOULD BE ADJUDGED UNDER THE RULE OF REASON SINCE THAT PRACTICE MATERIALLY DIFFERS FROM THE RESTRICTIONS CONDEMNED IN SCHWINN AND SERVES LEGITIMATE COMPETITIVE INTERESTS.

Sylvania's locations practice was conceived as the singular means for Sylvania's survival in the intensely competitive television market. It was the result of Sylvania's "entrepreneurial choice"[22] of the distribution technique

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[22]See Donald I. Baker, presently Assistant Attorney General, Antitrust Division, Department of Justice, *Vertical Restraints in Times of Change: From White to Schwinn to Where?,* 44 Antitrust L.J., 537, 541 (1975):

> "The antitrust commitment is to free markets, entrepreneurial choice, and consumer sovereignty. This commitment is bottomed on considerations of efficiency—on the belief that in the long run free markets will produce lower costs, lower prices and greater innovation. Yet 'reasonable' restraints have always been allowed, so long as they could be shown to help the competitive process work."

which its executives believed would accomplish that goal. It was further grounded in the notion that competitive market forces precluded Sylvania from achieving even minimal market success without directly involving itself in the characteristics of its dealers. Under compulsion of market forces Sylvania jettisoned three-tiered distribution in its major metropolitan markets in favor of direct manufacturer-retailer sales while adopting criteria for selection of dealers which Sylvania believed maximized its interbrand competitive potential. The criteria thus adopted included consideration of a particular dealer's location in the same way that it included consideration of the dealer's reputation in the community, business methods, and credit standing.

Since Sylvania's locations practice had both the purpose and effect of limiting the number of Sylvania dealers who might engage in intraband competition, those that chose to participate were not authorized to transship merchandise to nonapproved locations at which they might hold themselves out as Sylvania dealers. In this respect Sylvania's locations practice may be said to have imposed "restrictions". But the existence of such 'restrictions' simply frames the pertinent question; it does not answer it. That question is: does a locations practice such as Sylvania's invariably have such a "pernicious effect upon competition" without potential "redeeming virtue" so as to warrant *per se* condemnation without trial court evaluation of the purposes which prompted its origination and the effects which flowed therefrom in the marketplace? See *Northern Pacific Railway Co. v. United States*, 356 U.S. 1 (1958); *White Motor Co. v. United States*, 372 U.S. 253,

262 (1963).[23] Sylvania submits not. To the contrary, it is Sylvania's contention that a *per se* rule is inappropriate on the basis of this record and that the Ninth Circuit majority was correct in its holding that Sylvania was entitled to have its distribution practice evaluated by the trier of fact under the rule of reason.

A.

Sylvania's Locations Practice Differs Materially From the Restraints Held Unlawful in Schwinn

Prior to World War II vertical distribution restraints were uniformly upheld as lawful even if those restraints entailed a complete foreclosure of intrabrand competition. However, commencing in 1948 the Department of Justice, in announced reliance upon *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707 (1944), began to challenge as illegal *per se* vertical territorial and customer restrictions which totally foreclosed intrabrand competition. While succeeding years brought a number of consent decrees, it was not until *United States v. White Motor Co., supra*, that the Department's theory was judicially tested. It failed the test. Reversing summary judgment in favor of the Government, this Court stated that "[w]e need to know more than we do about the actual impact of these arrangments on competition to decide whether they have such a 'pernicious effect on competition and lack . . . any redeeming virtue' . . . and therefore should be classi-

[23]Indeed, in *Schwinn* itself, this Court, before reaching its partial *per se* result, stated that "[o]ur inquiry is whether, assuming nonpredatory motives and business purposes and the incentive of profit and volume considerations, the *effect upon competition in the marketplace is substantially adverse.*" 388 U.S. at 375. (Emphasis added.)

fied as per se violations of the Sherman Act." *White Motor Co. v. United States, supra,* 372 U.S. at 263.

Four years later the Department's claims against Schwinn were considered by this Court. But its theory of illegality had changed: although again challenging vertical restrictions entailing closed territories, the Department did not urge that those restrictions were unlawful *per se.* See Jurisdictional Statement of United States at 14. To the contrary, in its Brief the Government affirmed that its position before this Court was based on the rule of reason. Brief for the United States at 21-23. See 388 U.S. at 368, 373.[24] Be that as it may, this Court's resulting opinion in *Schwinn*—which applies both the rule of reason and a rule of *per se* illegality to differing aspects of Schwinn's distribution system—necessarily serves as the point of departure for evaluation of Sylvania's locations practice.

The Schwinn system, adopted at a time when it was the nation's second largest manufacturer of bicycles, involved three distinct marketing methods based on the differing roles of the middle-tier distributors:

1. distributors under the so-called "Schwinn Plan" acted as manufacturer's sales agents receiving a commission for obtaining orders for outright sales by Schwinn to franchised retailers;

2. distributors acted as conventional middlemen purchasing merchandise for resale to authorized dealers; and

3. distributors passed merchandise through their warehouses to franchised retailers in consignment or agency transactions.

[24]It is significant that as of this date neither the Department of Justice nor the Federal Trade Commission has brought a case challenging the validity of vertical restraints such as locations practices and exclusive distributorships which do not result in a complete foreclosure of intrabrand competition except where such restraints are allegedly collateral to price fixing or other illegal conduct. The Department, however, has unsuccessfully opposed the authorization of such practices in the decrees following remand in *United States v. Arnold, Schwinn & Co.*, 291 F.Supp. 564 (N.D. Ill. 1968) and *United States v. Topco Associates, Inc.*, 1973-1 Trade Cas. ¶74,391 (N.D. Ill.), *modified* 1973-1 Trade Cas. ¶74,485 (N.D. Ill.), *aff'd*, 414 U.S. 801 (1973).

All methods involved interrelated territorial and customer restraints imposed by contract. At the middle level each distributor was assigned a specific territory and was required to deal only with franchised retailers within that territory under penalty of termination. And at the dealer level Schwinn prohibited franchisees from selling to other retail dealers.

Upon review in this Court, the legality of these restraints was held to turn upon the form of the transactions involved. When the restraints were analyzed in conjunction with the "Schwinn Plan", agency and consignment transactions, they were held valid under the rule of reason. However, when the very same restraints were analyzed as an incident to the conventional middleman sales transactions, *per se* illegality followed by reason of "the ancient rule against restraints on alienation." 388 U.S. at 380. This Court said:

> "Under the Sherman Act, it is unreasonable without more for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it. *White Motor, supra; Dr. Miles, supra.* Such restraints are so obviously destructive of com-

petition that their mere existence is enough." 388 U.S. at 379.

In terms of the critical distinction thus drawn in *Schwinn,* Sylvania's locations practice plainly falls in the "post-sale" category. But the Sylvania practice differs materially—we submit decisively—in both form and effect from the post-sale restraints held unlawful in *Schwinn.* Unlike the practices considered in *Schwinn,* no purchaser from Sylvania was restricted or confined to a particular territory in which he could sell or deliver Sylvania products; nor was he subject to any restraint upon the customers to whom he might resell.[25] The only restriction was upon the locations at which the purchaser/retailer was franchised—locations which in every relevant market yielded effective competition with other Sylvania dealers as well as others. Thus, if this Court's holding in *Schwinn* is read with particular reference to the contractual territorial arrangements condemned by this Court—arrangements which at the distributor level immunized each unit from all others handling the same brand—the holding is plainly inapplicable to Sylvania's locations practice.[26]

[25]This fact puts an end to petitioners' arguments based upon the customer restraint aspects of this Court's holding in *Schwinn.* (See Pet. Br. 33-4). It was the territorial implications of a locations practice—and those implications alone—which prompted the *per se* jury instructions given below. See Conclusions of Law quoted *supra,* at 23-24 n. 19.

[26]The reading accorded the language and holding of *Schwinn* is a matter of considerable uncertainty. For example, concurring in *Albrecht v. The Herald Co.,* 390 U.S. 145 (1968), Mr. Justice Douglas, who was with the majority in *Schwinn,* noted that *Schwinn* was decided on the basis of a record which "elaborately sets forth information as to the total market interaction and interbrand competition, as well as the distribution program and practices" there challenged, 390 U.S. at 155-6. Similarly, Chief Justice Burger, dissenting in *United States v. Topco Associates, Inc.,* 405 U.S. 596, 617-18 (1972) read *Schwinn* as a case in which the Court "was proceeding under the 'rule of reason' and not by per se rule." See also Mr. Justice Marshall's pointed omission of vertical territorial restrictions from the category of *per se* violations in *United States v. Topco Associates, Inc., supra,* at 607-608. See generally ABA Antitrust Section, Monograph No. 2, *Vertical Restrictions Limiting Intrabrand Competition* (1977).

This reading is not Sylvania's alone. The difference between a contractual closed territorial system and a locations practice has been viewed as significant by every lower court which has considered the matter, both before and since *Schwinn.*[27] As the Ninth Circuit observed below, there are "no reported cases wherein a location clause

[27]This Court has not had occasion to rule upon the legality of a locations practice. In *United States v. General Motors Corp.,* 384 U.S. 127, 139-40 (1966), the Court declined to rule upon the legality of a locations clause which prohibited Chevrolet dealers from establishing new locations for the sale of Chevrolet vehicles without prior manufacturer approval even though the assertion of illegality was limited to circumstances where the clause was employed to prohibit dealers from selling to discounters for resale. See 384 U.S. at 139-40. In concurring, Justice Harlan expressed the view that "General Motors is not precluded from enforcing the location clause by unilateral action, and I find nothing in the Court's opinion to the contrary." 384 U.S. at 149. On remand the District Court adopted Justice Harlan's view and entered a final judgment which expressly stated that its injunctive provisions shall not "be construed to enjoin General Motors from acting unilaterally under any Chevrolet franchise agreement or from unilaterally enforcing any such agreement [including the locations clause]" except for a remedial six months' prohibition relating to sales to discounters. *United States v. General Motors Corp.,* Civil No. 62-1208-CC (S.D. Cal., August 17, 1966). Locations clauses were also involved in *United States v. Topco Associates, Inc.,* 405 U.S. 596 (1972), but the agreement there held unlawful was horizontal rather than vertical in character. Moreover, on remand the District Court expressly sanctioned the right of Topco Associates, Inc. to fix the locations of the trademark licensees except where doing so would achieve or maintain territorial exclusivity. *United States v. Topco Associates, Inc., supra,* 1973-1 Trade Cas. ¶74,391, ¶74,485. The District Court's judgment as thus entered was challenged on appeal here but summarily affirmed over Justice Douglas's dissent. 414 U.S. 801 (1973).

has been struck down for illegality." (Pet. Cert. App. A. 26-27). By contrast, several cases have held such practices subject to the rule of reason and lawful thereunder. The decisions range from *Boro Hall Corp. v. General Motors Corp.*, 124 F.2d 822 (2d Cir. 1942), *cert. denied*, 317 U.S. 695 (1943) through *Kaiser v. General Motors Corp.*, 530 F.2d 964 (3d Cir. 1976), *aff'g*, 396 F.Supp. 33 (E.D. Pa. 1975); and *Salco Corp. v. General Motors Corp., Buick Motor Division*, 517 F.2d 567 (10th Cir. 1975) to the Ninth Circuit Opinion here.[28] Commentators in the antitrust field have also viewed locations practices as different from the *Schwinn* restraints and have urged that such practices be judged under the rule of reason.[29]

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[28]Petitioners' reading of these authorities is peculiar at best (Pet. Br. 46-47). As they view the matter, these authorities are distinguishable because they involve "location franchises" which do not restrict a franchisee from shipping merchandise to a non-franchised location for resale. Not only is such a distinction unsupported by the text of these opinions, it is, as the Ninth Circuit majority put it, "highly artificial and even spurious". (Pet. Cert. App. A. 30, fn. 22). Franchising by location as utilized in modern product distribution means nothing if it does not entail express or implied limitations upon the authority of the retailer to transship merchandise to an unauthorized location for resale under the brand name whatever the particular trade style of the store. The Sylvania locations practice, like that in *Kaiser* and *Salco*, was a product of agreements expressly authorizing the dealer to sell and display products bearing the manufacturer's name. Such authorization was the primary purpose of the franchise. Indeed, it is by the dealer's sale, advertising and display of the manufacturer's line that he effectively holds himself out as an authorized dealer. (See Pet. Cert. App. A. 30-31, fn. 22.) Continental itself recognized these truths when it requested Sylvania's formal approval of its Sacramento location as a Sylvania outlet.

[29]See, *e.g.*, Robinson, *Recent Antitrust Developments—1974*, 75 Colum. L. Rev. 243, 276 n. 207 (1975); Jentes, *Permissible Vertical Restraints in Manufacturer-Distributor Relations*, 8 A.B.A. Antitrust Law Notes 97, 102 (Summer 1972) (locations clause stated to be, not only lawful, but the preferred type of manufacturer distributional restraint after *Schwinn*); Hanson, *American Bar Association Symposium on Marketing and Franchising: Antitrust Prognosis for the 70's*, 39 Antitrust L.J. 502, 516 (1970); McLaren, *Territorial and Customer Restrictions, Consignments, Suggested Retail Prices and Refusals to Deal*, 37 Antitrust L.J. 137, 144-5 (1968) ("A necessary element of the right to 'franchise' . . . is the right to have a 'location clause'."); Pollock, *Alternative Distribution Methods After Schwinn*, 63 Nw. U.L. Rev. 595, 603-4 (1968). Additionally, all law review notes to date concerning this proceeding have favored a rule of reason approach to Sylvania's practices. See 88 Harv.L.Rev. 636 (1975); 26 Mercer L.Rev. 629 (1975); 53 N.C.L.Rev. 775 (1975); 53 Tex.L.Rev. 127 (1975); 49 N.Y.U.L.Rev. 957 (1975).

The distinction is additionally reflected in the numerous lower court judgments applying the rule of reason to other vertical marketing techniques which, like a locations practice, involve "restraints" upon distributors which may inhibit or reduce intrabrand competition and the capabilities of distributors to undertake sales activities in remote areas. See, *e.g.*, *Colorado Pump & Supply Co. v. Febco, Inc.*, 472 F.2d 637 (10th Cir.), *cert. denied*, 411 U.S. 987 (1973) (primary responsibility clause obligating distributor to concentrate efforts in a specified geographical area upheld); *Superior Bedding Co. v. Serta Associates, Inc.*, 353 F.Supp. 1143 (N.D. Ill. 1972) (profit passover arrangement requiring dealer who makes sales within the territory of his neighbor to compensate the latter for promotional efforts, good will and the like upheld); *Belliston v. Texaco, Inc.*, 455 F.2d 175 (10th Cir.), *cert. denied*, 408 U.S. 928 (1972) (obligation to carry full or representative line upheld).

Petitioners dismiss the distinctions between the *Schwinn* type closed territorial system and Sylvania's locations practice as "whimsy" (Pet. Br. 32). As they would have it, any vertical distribution restraint is encompassed within the *per se* holding of *Schwinn* if that restraint is theoretically capable of producing economic effects which approximate Schwinn's closed system (Pet. Br. 31-35). A locations practice has such theoretical potential, petitioners argue, since the practical economics of the television industry precludes extensive marketing activities more than 25-50 miles beyond a particular location. It is thus possible, so the argument runs, for a manufacturer to set up a distribution system which, by virtue of the careful selection of authorized locations and the operation of economic forces, effectively precludes intrabrand competition.

This argument is flawed in several respects. First, even standing alone, petitioners' postulated model differs significantly from the *Schwinn*-type closed territorial restraint. It assumes that intrabrand competition is inhibited, not by contractual compulsion, but by economic limitations inherent in marketing. That difference alone justifies a fresh assessment of a locations practice under *Schwinn* based upon a reasoned evaluation of the purpose of the *Schwinn* holding.

Moreover, petitioners' model is a mere caricature: it has no analog either to Sylvania's distribution system or any other of which we are aware. Sylvania always authorized more than one franchise location in every market area relevant to this litigation, including Sacramento. So far as this record is concerned, there is no evi-

dence that any locations practice has ever been implemented in a manner materially differing from Sylvania's. To the contrary, reason suggests that locations practices are generally employed in product lines where distribution is so dense as to render exclusive territories undesirable or unworkable.

Most important, however, petitioners' analysis simply fails to accommodate the fact that other vertical practices with at least equally inhibiting impact upon intrabrand competition are regularly tested and upheld under the rule of reason. Foremost among these is the traditional "exclusive distributorship"—a marketing technique which, in terms of competitive purpose and effect, may be "much more restrictive of competition than Sylvania's location clauses." (Opinion, Pet. Cert. App. A. 37). Yet the legality of "exclusives"—at least when the arrangements involve an agreement by the manufacturer not to authorize any competing distributors to sell its product within a specified exclusive territory—was recognized in *Schwinn* itself. 388 U.S. at 376.[30] In fact, there is, as the opinion below properly notes, "a veritable avalanche of precedent to the effect that, absent sufficient evidence of monopolization, a manufacturer may legally grant such an exclusive franchise, even if this effects the elimination of another

[30] In *Denver Union Stock Yard Co. v. Producers Livestock Marketing Ass'n*, 356 U.S. 282 (1958), the Supreme Court held that stockyard regulations which barred market agencies from doing business in any other yard were unreasonable and discriminatory within the meaning of the Packers and Stockyards Act, 42 Stat. 159 (1921), 7 U.S.C. §181 *et seq.* In the opinion for the Court Justice Douglas observed:

> "The institution of the exclusive agency is, of course, well known in the law; and the legal problem here would be quite different if the Act envisaged stockyards as strictly private enterprise." 356 U.S. at 288.

distributor."[31] (Pet. Cert. App. A. 37 and cases there cited.) These cases stand for the proposition that distributional efficiency is a legitimate interbrand competitive goal which may be furthered by restrictions in manufacturer-distributor dealings so long as the restrictions are reasonably circumscribed by that end.[32]

Petitioners would dismiss the exclusive dealing precedents on the grounds that they involve only self-imposed inhibitions upon a manufacturer's own sales decisions

[31]These authorities dispose of the suggestion implicit throughout petitioners' argument that the legality of Sylvania's locations practice and its enforcement with respect to Continental might turn upon the fact that Sylvania allegedly acted in response to "complaints" by Handy Andy in Sacramento. If Continental acted in breach of its understandings with Sylvania and in derogation of a lawful locations practice, Sylvania's entitlement to terminate was established regardless of any favored dealer's urgings. See *Joseph E. Seagram & Sons, Inc. v. Hawaiian Oke and Liquors, Ltd.*, 416 F.2d 71 (9th Cir. 1969), *cert. denied*, 396 U.S. 1062 (1970). See also *Packard Motor Car Co. v. Webster Motor Car Co.*, 243 F.2d 418 (D.C. Cir.), *cert. denied*, 355 U.S. 822 (1957); and *Schwing Motor Co. v. Hudson Sales Corp.*, 138 F.Supp. 899 (D. Md.), *aff'd per curiam*, 239 F.2d 176 (4th Cir. 1956), *cert. denied*, 355 U.S. 823 (1957), in which courts refused to grant relief to automobile dealers whose dealerships had been eliminated because their larger competitors demanded and received from the manufacturer as a condition of continued distribution of the manufacturer's products, an exclusive dealership and agreement to terminate the plaintiffs. See also, *e.g.*, *Beckman v. Walter Kidde & Co., Inc.*, 316 F.Supp. 1321 (E.D.N.Y. 1970), *aff'd*, 451 F.2d 593 (2d Cir. 1971), *cert. denied*, 408 U.S. 922 (1972): ("But it is well settled that exclusive franchises in non-monopoly lines of commerce are permissible . . . even if they result in cutting off other distributors.") 316 F.Supp. at 1327; *Top All Varieties Inc. v. Hallmark Cards Inc.*, 301 F.Supp. 703 (S.D.N.Y. 1969) (plaintiff failed to state claim when he alleged that Hallmark refused to supply its line to a new, additional store location pursuant to an agreement with another dealer). Compare also Note, *Restricted Channels of Distribution Under the Sherman Act*, 75 Harv.L.Rev. 795 (1962).

[32]For a discussion of the effects of exclusive franchises upon competition, see, *e.g.*, Scherer, *Industrial Market Structure and Economic Performance* 541 (1970).

rather than resale restrictions upon "independent traders" (See Pet. Br. 43-4, echoing the theme advanced in Judge Browning's dissent below, Pet. Cert. App. A. 88-90.)[33] This formulation, however, merely begs the question. For the issue is not whether these precedents *can be* so interpreted, but whether they *should be*. If, as a matter of antitrust policy, the limiting effects upon intrabrand competition resulting from exclusive distributorships is recognized and accepted, why, at the same time, should the law be interpreted in an artificial and one-sided way so as to render such practices meaningless? As Professor (and former Assistant Attorney General) Donald Turner has observed:

> "The point is very simple: If I set up as a dealer in Baltimore and I don't want any more dealers in Balti-

[33]With respect, Judge Browning's dissent below ignores the reality of distributor bargaining power in its analysis of the issue. In modern American commerce, retail chains often possess equal or greater bargaining power than that possessed by the manufacturer, particularly when, like Sylvania, the manufacturer is struggling to obtain a meaningful share of the market, *cf.* Baker, *Vertical Restraint in Times of Change: From White to Schwinn to Where?*, 44 Antitrust L.J. 537 (1975). Judge Browning—like petitioners—would derive a *per se* rule from an unsubstantiated model in which the manufacturer is invariably supreme in "imposing" its contractual will upon its seemingly hapless dealers. However, petitioners' own conduct in conjunction with the Young Bros. incident belies the efficacy of both the model and the analysis. For the Young Bros. incident in June 1965—before Continental's involvement in Sacramento and before product shortages in the fall of 1965 made all television lines indiscriminately desirable—evidences Continental's conviction that its localized market power endowed it with sufficient "muscle" to "coerce" Sylvania into acceding to its wishes respecting enfranchising new dealerships. While Continental proved unsuccessful in this endeavor, the vignette suggests that the "normal populist assumption" that the "large manufacturer" possesses the power to "coerce" local dealers in terms of marketplace decisions is inapplicable to the television industry in general and to struggling manufacturers in that industry in particular. The actual situation appears to have been one of "give and take" bargaining

more, the only way that I can make that stick is to tell the Washington dealer that he can't set up an establishment in Baltimore." *1968 Antitrust Law Symposium of the New York State Bar Association,* at 61.

Further, the suggestion that exclusives be treated as a "one-way" inhibition upon manufacturers ignores the practical effect of such analysis. If a manufacturer may lawfully be precluded from opening other dealers within an "exclusive" territory (which petitioners concede), that inhibition necessarily forecloses any other *prospective* dealer from obtaining such a franchise. Compare Pollock, *The Schwinn Per Se Rule: The Case for Reconsideration,* 44 Antitrust L.J. 557, 570-71 (1975). Viewed from that perspective, the "exclusive" is not a one-way limitation *against* manufacturers, but a one-way limitation *in favor of* already established dealers who alone would benefit from petitioners' suggested interpretation.[34]

Finally, it is plain that both the competitive purposes and effects of distribution systems employing exclusive dealing arrangements are similar to—if not more restric-

[34]Again to quote Mr. Turner, "[T]he ideal arrangement is where [the exclusive] is at the option of the manufacturer, that is, where of his own free will, at a particular point, he chooses to sell to only one person in a particular territory, but remains free of any contractual commitment to continue that for any length of time. I say this because in this whole area one of the things you have to fear is that the distributors will be initiators of these restraints, and by and large their interests are likely to be simply anti-competitive and against the consumer's interest." *1968 Antitrust Law Symposium of the New York State Bar Association, supra,* at 62. In this connection it should be noted that Continental, in opposing Sylvania's franchising of Young Brothers in San Francisco, unsuccessfully attempted to convert Sylvania's locations practice, from one in which Sylvania made decisions on additional dealer locations into a more restrictive practice by which such decisions would be subject to Continental's veto of competition unacceptable to it. See *supra,* at 15.

tive than—those involving locations practices. The whole point of exclusives, after all, is to further interbrand competitive capabilities by providing select dealers with territories substantially insulated from intrabrand competition. As *Schwinn* itself recognizes, the exclusive dealing practice is subject to the rule of reason because it, like a locations practice, can serve legitimate pro-competitive interests. While the party subject to the "restraint" might be said to differ, a locations practice possesses the same pro-competitive potential as "exclusives"—a potential fully realized on the evidence adduced here. The mere identity of the contracting party "restrained"—be it manufacturer or distributor—informs not at all when the inquiry is directed to the effect of the practice upon competition.

It comes to this: the pertinent legal authorities, both before and after *Schwinn,* provide no warrant for striking down a locations practice on a *per se* basis. On the contrary, absent rigid compartmentalization of a distribution system into separate units effectively isolated from all intrabrand competition,[35] lower courts have consistently and properly evaluated the purpose, scope and effect of vertical restraints under the rule of reason. To invalidate a locations practice on the authority of *Schwinn* would be a mechanical extension of the *Schwinn* holding

[35]Vertical "closed territory" practices have been held unlawful under *Schwinn* in such cases as *Adolph Coors Co. v. FTC,* 497 F.2d 1178 (10th Cir. 1974), *cert. denied* 419 U.S. 1105 (1975); *Copper Liquor, Inc. v. Adolph Coors Co.,* 506 F.2d 934 (5th Cir. 1975); *Hobart Bros. Co. v. Malcolm T. Gilliland, Inc.,* 471 F.2d 894 (5th Cir.), *cert. denied,* 412 U.S. 923 (1973); *cf. Noble v. McClatchy Newspapers,* ..... F.2d ..... (9th Cir. 1976) (*pet. for cert. filed* July 27, 1976) (No. 76-86); *Reed Brothers, Inc. v. Monsanto Chemical,* 525 F.2d 486 (8th Cir. 1975), *cert. denied,* ..... U.S. ..... (1976).

without a clear demonstration that the proscribed practice is anticompetitive. See Elman, *"Petrified Opinions" and Competitive Realities,* 66 Colum. L.Rev. 625, 627 (1967). The result might well be to throttle competition *(cf.* Pet. Br. 32), rather than to further it.

B.

Sylvania's Locations Practice Serves Legitimate Competitive Interests Without Appreciable Detriment and Is Therefore Entitled to Be Adjudged Under the Rule of Reason.

Sylvania's locations practice is similar to that which manufacturers in "specialty" or "shopping goods" have turned to in the last several decades for the purpose of maximizing distributional efficiency.[36] While various techniques have been employed, marketing systems centering around the sale of products connected with recognized trade names have often utilized franchise agreements which, to a greater or lesser extent, subject the dealer or retailer to various controls over his business operations. Such controls include in addition to locations restrictions such diverse practices as best efforts clauses, area of primary responsibility covenants, prohibitions against misrepresentations, full or representative line obligations, and duties respecting warranties. All further legitimate interests of the manufacturer by enhancing the quality and

[36]See, *e.g.,* Senate Select Committee on Small Business, 92 Cong., 1st Sess., Report on the Economic Effects of Franchising (Comm. Print 1971); E. Lewis & R. Hancock, *The Franchise System of Distribution* (1963); *Franchising,* a Federal Trade Commission Staff Report on Legal Problems in Connection with Franchise Agreements, December 10, 1969 (1969 Trade Reg. Rep. 444, December 15, 1969, Supp.); Zeidman, *The Growth and Importance of Franchising—Its Impact on Small Business,* 12 Antitrust Bull. 1191 (1967).

effectiveness of the manufacturer's distribution system,[37] thereby maximizing interbrand competitive potential.[38]

While such controls plainly enhance the interbrand competitive capabilities of manufacturers, they also offer significant benefits for dealers. This is particularly true with respect to those which have a territorial dimension. Indeed, the very existence of vertical restrictions may reflect the fact that retailers have bargained for competitive "spacing" as a *quid pro quo* for their willingness to carry the line and subject themselves to various operational controls. See Scherer, *supra,* at 510; Baker, *supra,* at 542. Such "spacing" is avowedly designed to provide each dealer with sufficient security from intrabrand "flooding" so as to recompense him for the investment of time, energy and money necessary to carry and promote the product line. As a consequence, the dealer's ability to retain a position as a viable independent part of the American economic system is enhanced. See, *e.g.,* Justice Stewart's concurring and dissenting opinion in *Schwinn,* 388 U.S. at 386-7.

[37]See *Joseph E. Seagram & Sons, Inc. v. Hawaiian Oke & Liquors Ltd., supra,* 416 F.2d at 80: "A manufacturer or supplier has a legitimate interest in the quality, competence, and stability of his distributors."

[38]Distributional efficiency is not the only basis for these restrictions. The modern consumer economy now demands that the manufacturer assume direct responsibility for product safety and quality irrespective of whether the dealer from which the consumer purchases is "authorized" or has title to the goods at the time of purchase. For example, under California's Song-Beverly Consumer Warranty Act a manufacturer of consumer goods for which the manufacturer makes express warranties is obligated to provide sufficient service and repair facilities in the state to carry out the terms of such warranties or be liable to every retail seller of such goods who gives effect to express warranties whether or not such retailer be "franchised". See California Civil Code §1790 *et seq.*

With particular reference to a locations practice such as Sylvania's, these benefits are not offset by significant adverse effects upon intrabrand competition. While a locations practice limits the number of competitive units selling products in a particular market area, the practice demonstrably does not foreclose consumers from substantial choice among competing dealers. As a consequence, any dealer who might become inclined to charge too high a price or to provide poor service is always subject to an intrabrand competitive check—a check heightened here by the fact that Sylvania at all times reserved the right to franchise additional dealers free of any "veto power" at the dealer level. At most, therefore, intrabrand competition is limited, not eliminated.

When viewed in the round—both in terms of the evidence at trial and the available tools of economic analysis—a locations practice such as Sylvania's must be perceived as potentially pro-competitive in "net effect" and thus an inappropriate subject for *per se* interdiction. As analyzed in Note, *supra,* 88 Harv.L.Rev. at 641:

> "In sum, location restrictions such as Sylvania's encourage dealers to carry and promote the manufacturer's product, thus strengthening its competitive position against other brands on the market. At least where the product is new or has a low market share, location restrictions may thereby produce gains in interbrand competition. Moreover, the anticompetitive effect of limiting intrabrand competition is not likely to be significant where a manufacturer has only minimal market power, since intrabrand competition provides a check on the dealers' price levels. Therefore, location restrictions may often produce net benefits for competition. Even so, reduction of

> investment risk and imposition of efficient scales of operation is not considered to be a sufficient justification for horizontal market division agreements. However, vertical arrangements do not create the same danger that output will be restricted, artificially raising prices and profits. Generally a manufacturer would prefer the lowest retail price possible, once its price to dealers has been set, because a lower retail price means increased sales and higher manufacturer revenues. Thus, vertically imposed location restrictions which limit intrabrand competition will presumably serve to increase distributional efficiency. Accordingly, vertical location restrictions should not be illegal per se. (Footnotes omitted.)"[39]

Finding themselves without a substantial economic basis for *per se* condemnation of a locations practice, petitioners argue that an expansive *per se* rule is nonetheless incumbent by reason of concerns over judicial efficiency and competency. A rule of reason inquiry, it is said, would impel the Court to "set sail on a sea of speculation" (Pet. Br. 39) in the hopeless task of resolving a "nonjusticiable issue" (Pet. Br. 26). Moreover, petitioners argue that *United States v. Topco Associates, Inc.,* 405 U.S. 596 (1972), precludes a rule of reason assessment of possible benefits to interbrand competition as a basis for

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[39]For other analyses of the economic effects of various vertical restrictions, see, *e.g.,* Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions,* 75 Colum.L.J. 282 (1975); Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division,* 75 Yale L.J. 373, 430-453 (1966); Comanor, *Vertical Territorial and Customer Restrictions: White Motor and Its Aftermath,* 81 Harv.L.Rev. 1419, 1426-33 (1968); Preston, *Restrictive Distribution Arrangements: Economic Analysis and Public Policy Standards,* 30 Law & Contemp. Prob. 506, 511-12 (1965). See also the trial court testimony of Lee E. Preston, Jr. (R.T. 2872-2970; A. 401-474).

sanctioning "certain harm" to intrabrand competition (Pet. Br. 39-41).

But concern over judicial efficiency is no substitute for reasoned antitrust policy—policy which ought to demand that a practice not be categorically rejected as unreasonable simply because of its effects upon one aspect of competition where there is compelling evidence of benefit overall. See Note, *supra,* 88 Harv.L.Rev. at 642.[40]

Nor does *United States v. Topco Associates, Inc., supra,* compel a contrary view. *Topco* involved horizontal territorial and related restraints—practices with respect to which "net competitive damage" is reasonably predictable. It is otherwise in a vertical context. When, as here, a manufacturer has joined with its distributors to form a distribution system engaged in an economic battle with competing brands, "it is myopic to concentrate only on the possible diminution of *intra*-brand competition and ignore the advantages to *inter*-brand competition. Elementary cost-benefit analysis would seem to require consideration of the *net* competitive effect of a vertical restriction—and not merely the effect on one side of the balance sheet." Pollock, *supra,* 44 Antitrust L.J. at 568 (emphasis in original). (See also Opinion, Pet. Cert. App. A. 45-6).

But the ultimate repudiation of petitioners' argument —particularly when directed at judicial competency—is

[40]In this connection, we commend to the Court the comment of Circuit Judge Duniway, dissenting below:

> "I cannot, however, refrain from making one small observation. I am puzzled by the notion that because the courts are not very well equipped to decide between conflicting notions of economic policy, they should pick one side of such an argument and erect it into a rule of per se illegality." (Pet. Cert. App. A. 114).

found in *Schwinn* itself. For there this Court affirmed the trial court's finding that Schwinn's restrictions were lawful under the rule of reason as respects "Schwinn Plan", consignment and agency arrangements. After referencing such facts as the availability of competing lines and the absence of exclusive dealing and price fixing practices, Mr. Justice Fortas stated:

> "[W]e cannot disagree with the findings of the trial court that competition made necessary the challenged program; that it was justified by, and went no further than required by, competitive pressures; and that its net effect is to preserve and not to damage competition in the bicycle market. Application of the rule of reason here cannot be confined to intrabrand competition. When we look to the product market as a whole, we cannot conclude that Schwinn's franchise system with respect to products as to which it retains ownership and risk constitutes an unreasonable restraint of trade." 388 U.S. at 381-2.

To be sure, a rule of reason trial may encounter difficult problems of proof and evaluation. But such problems are no different in kind from those encountered in resolving other questions under the antitrust laws such as whether a conspiracy has occurred or whether there has been an attempt to monopolize, not to mention assessment of damages. All arguably involve matters of "unfathomable economic complexity" (Pet. Br. 42), but all have been routinely confronted by the Justice Department and private claimants alike without trepidation or paralysis. Given this experience, petitioners' assertion that "it is impossible to tell whether conceded elimination of intrabrand competition in fact has off-setting pro-

competitive interbrand effects" (Pet. Br. 26) should be viewed as nothing more than a confession of evidentiary poverty.[41]

There remains only petitioners' claim that *per se* interdiction of a locations practice would further the goal of certainty or predictability in commercial relationships between manufacturers and dealers (Pet. Br. 41-2). That claim, however, proves nothing or everything. It proves nothing because the goal of predictability or certainty can be equally accomplished by a clear holding that a locations practice is presumptively lawful under the rule of reason, as petitioners themselves acknowledge with re-

[41]Contrary to petitioners' argument (Pet. Br. 42-49), the availability *vel non* of "less restrictive alternatives" provides no analytical assistance in determining whether a *per se* rule ought to apply to a challenged trade practice. Were it otherwise, it is probable that all vertical distribution techniques would be invalidated since "there will almost always be a less restrictive alternative, and indeed, further alternatives to each alternative *ad infinitum*." Handler, *Twenty-five Years of Antitrust* (25th Annual Antitrust Review) 73 Colum.L.Rev. 415 (1973). To the extent that the "less restrictive alternative" notion is pertinent at all, it is only after the rule of reason is deemed applicable. For then the "less restrictive alternative" formulation becomes "a verbal variant of the traditional rule of reason inquiry into whether a restraint of trade is reasonably necessary to accomplish a legitimate objective and therefore lawful despite its anticompetitive effect." Robinson, *Recent Antitrust Developments: 1975*, 76 Colum.L.Rev. 191; 232 (1976). Even under the rule of reason, however, the pertinence of alternatives is limited. As Judge Adams stated in *American Motor Inns, Inc. v. Holiday Inns, Inc.*, 521 F.2d 1230, 1249 (3d Cir. 1975), it would be error to conclude "that, regardless of the other circumstances present, the availability of an alternative means of achieving the asserted business purpose renders the existing arrangement unlawful if that alternative would be less restrictive of competition no matter to how small a degree." Any other rule "would place an undue burden on the orderly conduct of business." It is also worth noting that this Court in *Schwinn* made no reference to the "less restrictive alternatives" notion in any part of its analysis. Finally, it is doubtful at best that the alternatives to which petitioners advert are actually "less restrictive" than a locations practice.

spect to such vertical arrangements as exclusive distributorships (Pet. Br. 42). It proves everything because its logic compels that all trade practices be peremptorily outlawed or sanctioned thereby dispensing with the rule of reason entirely.

However desirable certainty or predictability, such concerns ought not to deflect the Court from the proper focus of inquiry: is the practice in question so invariably pernicious in terms of its competitive purposes and effects as to warrant outright condemnation? If not, the practice should be subject to a rule of reason scrutiny. While the result might be a few more trials, that is scarcely a detriment which warrants condemnation of potentially legitimate business practices.

II

IF THE HOLDING IN SCHWINN ESTABLISHED A PER SE RULE WHICH INVALIDATES LOCATIONS PRACTICES, THEN SCHWINN OUGHT TO BE RECONSIDERED.

A.

Schwinn's per se language unduly inhibits the legitimate interests of manufacturers in the selection of their product distribution systems.

This Court's opinion in *Schwinn* has been the subject of more intense scrutiny and criticism than any other recent decision in the antitrust field.[42] Most of this criti-

[42]A compendium of critical comments appears in the opinion below (Pet. Cert. App. A. 18, fn. 13). The Court's attention is also invited to two articles appearing since the decision below: Baker, *Vertical Restraints in Time of Change: From White to Schwinn to Where?*, 44 Antitrust L.J. 537 (1975) and Pollock, *The Schwinn Per Se Rule: The Case for Reconsideration*, 44 Antitrust L.J. 557 (1976).

cism has centered upon the invocation of "the ancient rule against restraints on alienation" as the underpinning for the *per se* rule there announced and upon the important legal distinctions which were made to turn on the form as opposed to the competitive consequences of the challenged transactions. As observed by a recent article in the Columbia Law Review:

> "The hue and cry engendered by *Schwinn* was readily understandable. In striking down post-sale restrictions as necessarily violative of section 1, the Court did not simply abruptly end its short-lived search for 'the economic and business stuff out of which these arrangements emerge;' it also swept aside a venerable body of law sustaining such restraints under the traditional rule of reason as legitimate means for fostering effective interbrand competition. Even more perplexing, the Court predicated its new prohibition on a theoretical doctrine which Justice Stewart tersely characterized in his dissent as 'a wooden and irrelevant formula'—the so-called 'ancient rule against restraints on alienation.' Curiously enough, this 'ancient rule' had not even been mentioned in *White Motor,* except for a passing reference by Justice Brennan in his concurring opinion, and then only to emphasize that the mere existence of restraints on alienation should not conclusively establish illegality. Moreover, since it is doubtful that an undeviating rule against such restraints ever existed, even at common law, the jurisprudential underpinnings of *Schwinn* were anything but sturdy." Robinson, *Recent Antitrust Developments: 1974,* 75 Colum. L. Rev. 243, 270-271 (1975). (Footnotes omitted.)[43]

[43]For further criticisms of Justice Fortas' reliance upon the "ancient rule", both in terms of its common law origins and its irrelevance to competitive concerns under the Sherman Act, see

To similar effect, Professor (now Assistant Attorney General, Antitrust Division) Donald Baker has noted that:

> "[t]he root error in *Schwinn* is that everything turns on the bare form of the transaction. Is it a 'sale'? Is it a 'consignment'? Is it something else—such as a sale subject to a continuing equitable interest or a security right? If it is one thing, the rule seems too tolerant of intrabrand restraints. If it is another, the rule is probably too rigid and inflexible." 44 Antitrust L.J. at 538.

These criticisms themselves suggest a sufficient basis for reexamination of *Schwinn's per se* language. However, Sylvania submits that both the holding in *Schwinn* and its rationale derive from a more fundamental error, namely, the Court's apparent designation of dealer sovereignty as the overriding antitrust value in vertical distribution relationships. Stated otherwise, *Schwinn's* premise is that sound antitrust policy must give priority to the decision-making integrity of dealers who have taken the economic risk that they will be unable to market their products successfully. See generally Averill, *Sealy, Schwinn and Sherman One: An Analysis and Prognosis,* 15 N.Y.L.F. 39, 64 (1969).

As viewed by the *Schwinn* majority, to the extent Schwinn's dealers had purchased bicycles and thereby assumed the risk that they would remain unsold, they

Handler, "The Legality of Exclusive Representation Agreements and Territorial Provisions Ancillary to Trademark Licensing," Hearings on Exclusive Territorial Allocation Legislation Before the Subcommittee on Antitrust and Monopoly of the Senate Judiciary Committee, 92d Cong., 2d Sess. Pt. II at 906-909 (1972); Handler, *The Twentieth Annual Antitrust Review—1967,* 53 Va.L.Rev. 1667, 1685-86 (1967) and Posner, *supra,* at 295-96.

could not be restricted in any way in their right to "alienate" them. By contrast, where *Schwinn* retained "title, dominion, and risk" that standard yielded to a rule of reason inquiry and a relaxed one at that. See 388 U.S. 380-82. This was true notwithstanding the fact that the competitive impact of the two approaches was substantially identical in the sense of "confining distribution outlets." 388 U.S. at 380. Moreover, the *Schwinn* majority cited with approval the principle that a non-monopolist manufacturer has the right to select its dealers and to refuse to deal entirely—a right presumably countenancing the establishment of a system of geographically spaced exclusive distributors or dealers. Since exercise of this right may result in a distribution system substantially insulated from intrabrand competition, it is scarcely debatable that this Court was concerned with something other (or, at least, in addition to) the mere existence of limitations upon same-brand competition.

The difficulty with this analysis is that while the Court purports to recognize that both manufacturers and dealers have competitively legitimate interests in controlling the nature of their respective businesses, the practical impact of the decision is largely to negate the manufacturer's ability to define and implement a product distribution system of its choosing. This follows from the implicit assumption of *Schwinn* that a manufacturer has no legitimate continuing interest in the distribution of its products after the initial sale or that such interest is, in all events, outweighed by the dealer's interest in unfettered economic discretion. Thus, although the Court refers favorably to a manufacturer's right to select its

dealers in the first instance, the necessary import of the *Schwinn* holding is that once the decision to enfranchise is made it becomes, as a practical matter,[44] largely irreversible (for non-credit reasons) no matter how the nature of the dealer's business or the competitive situation may have changed. *In other words: once a dealer, always (and everywhere) a dealer.* Compare 88 Harv. L. Rev., *supra* at 646.

To illustrate by reference to the facts of the present case (which are said to be controlled by *Schwinn*), it is clear that Sylvania neither needed nor wanted a new

[44]The manufacturer's supposed unilateral right under *Colgate* to "announce in advance" the terms upon which he will deal is at best unrealistic as applied in the present context. See *supra*, at 10, fn.5. The notion that major manufacturers will be able with any frequency to produce evidence of sufficient "Dorie simplicity" (*George W. Warner Co., Inc. v. Black & Decker Mfg. Co., Inc.*, 277 F.2d 787, 790 (2d Cir. 1960)) to satisfy the *Colgate* test challenges common sense as well as experience. This is particularly true in light of the much-expanded notions of "combination and conspiracy" derived from decisions such as *Albrecht v. The Herald Co., supra.* The principal problem with *Colgate* is that it is based upon a postulated business environment which fails to conform to reality. Also, the line between what is permitted and what is proscribed is difficult to ascertain or apply in the ordinary business context. Even for lawyers who regularly practice at the antitrust bar the boundaries of permissible unilateral conduct are elusive and the source of much disagreement. See, *e.g.*, Turner, *The Definition of Agreement under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 Harv. L. Rev. 655 (1962); Panel Discussion, *Refusals to Deal*, 42 Antitrust L.J. 325 (1973). Moreover, unlike the ordinary situation in which reasonably careful planning by corporate officers and their counsel ensures full antitrust compliance, attempted satisfaction of the *Colgate* standard is often undercut by relatively low-level corporate employees, whose transgressions often come to light only after the fact of termination has been accomplished. Not infrequently, a seemingly whistle-clean termination is irretrievably sullied by prior threats communicated to, or assurances received from, the account by a salesman or area manager. See, *e.g.*, R. Pitofsky and K. Dam debating *Is The Colgate Doctrine Dead?*, 37 Antitrust L.J. 772 (1968).

retail outlet in Sacramento. Had some "stranger" approached it with a request to open a Sylvania dealership there, it would have been turned down. However, having franchised Continental to operate in San Jose and other locations, it is now argued that *Schwinn*-based doctrine required Sylvania to continue to deal with it and to supply merchandise for Continental's unwanted Sacramento store.

That, we submit, ought not to be the law. Why should the decision of Sylvania to sell television sets to the "old" Continental for its operation in one location be ossified into an unbounded commitment to deal with the "new" Continental having operations elsewhere? Or, to put the matter another way, why should the entrepreneurial choice of manufacturers be limited to the pre-selection stage? Isn't Sylvania's decision not to accept Continental as a dealer in Sacramento effectively the same decision moved back to a different point in time?

Sylvania submits there is no sound "antitrust" reason for treating the two situations differently. If a dealer elects subsequently to exercise his discretion to change the nature of his operations by, *e.g.*, selling from different locations or to different functional levels of customers, why should the manufacturer (provided price is not in issue and that other competing products are freely available) not be free to exercise, in good faith, its discretion not to deal further with him?

The locations practice which Sylvania utilized here was no more than the necessary corollary to the recognized right of a manufacturer to franchise at certain locations and to deal with certain dealers only. On the other hand,

Continental's decision to open another store was not simply an exercise of a dealer's discretion to determine how best to market its products but rather a fundamental change in the nature and scope of its operations. Given these circumstances, Sylvania submits that it should be every bit as entitled to decline to deal *at that point* as it was when the decision to sell or not to sell was first posed. At the very least, that action should be adjudged by its reasonableness, and not as a *per se* offense.

The fundamental question which should be addressed is not whether a manufacturer may impose restrictions upon the disposition of goods after transfer of title and risk of loss, but rather whether a manufacturer retains a continuing interest in the nature of its distribution system and dealers sufficient to justify a factual inquiry into the purposes and effects of its distribution practices.[45] There is no question that, to the extent Continental had acquired Sylvania merchandise, it was, and should be, free to dispose of it as, how and where it elected. That "sover-

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[45]See Elman, *"Petrified Opinions" and Competitive Realities*, *supra* at 630-31:

> "[I]n a modern economy it is nonsense to say that it is none of the manufacturer's business how his product is marketed to the consuming public; that once he parts with legal title when he sells to the wholesaler or retailer, he has lost the right to participate in the marketing of his product to the consumer. Today's manufacturer not only has that right, but exercises it all the time; and he does so because he is competing, as he must and should, with manufacturers of rival products and brands. Thus, a manufacturer's participation in the marketing of his product at the retail level can be held unlawful, certainly not on the ground that he has no business being there, but only on the ground that, by his actions at the retail level, he is unjustifiably limiting competition."

eignty", however, is far different from the position urged by Continental: that its right of "entrepreneurial choice" guaranteed to it the right to become a retailer of Sylvania merchandise in any market it chose, or to change the nature of its operations without legal objection or response by Sylvania. To the contrary, we submit that due regard for the equivalently important "entrepreneurial choice" of Sylvania as to how best to market its products (for the benefit of itself *and its dealers*) requires, not *per se* interdiction, but evaluation under the rule of reason.[46]

B.

Schwinn's Per Se Language Fails to Promote Either Inter- or Intra-Brand Competition.

Not only is *Schwinn* imbalanced in its premises, but the competitive consequences of the decision are seemingly contrary to those which were intended. The articulated basis of the Court's opinion is that Schwinn's practices were to be evaluated in terms of their "effect" upon "competition in the marketplace". 388 U.S. at 375. Yet, if that be the goal (and Sylvania agrees that it should), both the opinion itself and the experience sub-

[46]Our discussion of *Schwinn* is premised on the assumption that the restrictions in issue are imposed in a competitive market setting and are vertical in nature. As *Schwinn* itself recognizes, the unfettered right of a manufacturer to exercise its "entrepreneurial choice" in selecting dealers and defining its distribution system exists only where other competitive products are freely available. 388 U.S. at 376. Similarly, a manufacturer must act in its own competitive interests and not merely as the agent of a horizontal dealer cartel as in *United States v. General Motors Corp., supra; cf.* also *United States v. Sealy*, 388 U.S. 350 (1967).

sequent thereto[47] suggest that the majority failed to achieve its stated objective in at least three respects.

First, it is largely conceded that whatever their effect upon intrabrand competition at the dealer level, nonprice vertical restraints may, and frequently do, promote interbrand competition. See, *e.g.*, Warren, *Economics of Closed-Territory Distribution*, 2 Antitrust Law and Econ. Rev. 111 (1968); Preston, *supra;* Bork, *supra.* See additionally ABA Antitrust Section Monograph No. 2, *supra.* Indeed, the Court's observation concerning "competition in the marketplace" must be read as referring to intrabrand competition alone since the opinion acknowledges at several points that Schwinn's distribution practices were responsive to its declining market share and the intense competition it faced from mass merchandisers (such as Sears and Montgomery Ward) and the substantially cheaper (*circa* 1962) foreign imports. In fact, so long as title and risk of loss remained with Schwinn this Court was quite willing to approve the competitive reasonableness of the defendants' practices. While concern with dealer sovereignty prevented a similar result in the postsale context, it is surely clear that the interbrand com-

[47]The post-*Schwinn* experience has been summarized by Mr. Robinson as follows:

> "More surprising, however, is the rough treatment accorded the decision by the lower courts. One would ordinarily expect an authoritative determination by the Supreme Court to be followed obediently irrespective of its logical persuasiveness. *Schwinn*, however, has not received such deference. Evidently recognizing that a total prohibition of restraints on alienation would produce unpalatable results, judges have struggled to distinguish or limit *Schwinn* in ways that are a tribute to judicial ingenuity." Robinson, *Recent Antitrust Developments: 1974*, 75 Colum.L.Rev. at 272.

petitive impact of the programs was identical in both instances.

Second, the Court's opinion was obviously motivated by concern for the viability of small business units. However, the consequences of the decision seemingly point in precisely the opposite direction. Assuming *arguendo* that application of *Schwinn* might result in a short term increase in intrabrand competition, the long-run effect of the decision must necessarily be to favor vertical integration and the interests of large manufacturers who can afford to implement and support a true consignment system. See, *e.g.*, Posner, *supra* at 296-7; Baker, *supra* at 538, *Schwinn, supra,* at 386-7 (Stewart, J., concurring and dissenting). In fact, it appears that as a direct result of this Court's decision, Schwinn itself became vertically integrated to a large degree, thereby eliminating many of the very dealers whose protection this Court had sought to promote. See Keck, *The Schwinn case,* 23 Bus. Law. 669, 686-7 (1968); Pollock, *Alternative Distribution Methods After Schwinn,* 63 Nw. U.L. Rev. 595, 610 n. 60 (1968). *Schwinn* similarly militates against use of a three-tiered distribution system at all, since it is obviously safer under that decision to sell directly to pre-selected retailers.[48]

Finally, and of equal importance, there remains a significant question whether even the limitation upon *intra*brand competition which undeniably resulted from

[48]Merely eliminating the distributor level, of course, gives no assurance that a manufacturer will be able to retain the type of distribution system it intends. For example, in *Schwinn* itself, some of defendants' established retailers had, in effect, elected to become wholesalers of Schwinn merchandise, reselling it to retailers with whom Schwinn and its distributors had elected not to deal.

Schwinn's practices warrants a sweeping *per se* rule. At issue in *Schwinn,* after all, was not simply an attempt by the defendants to restrict intrabrand competition at the distributor level but also an effort to prevent certain dealers from taking advantage of the good will previously developed by Schwinn and its other dealers by creating a "second line" of distribution among mass merchandisers and other types of retailers with whom Schwinn did not choose to deal. See 388 U.S. at 368-70. The effect of the Court's decision was that Schwinn was legally precluded from responding to those efforts without adopting a total consignment system or vertically integrating—as it ultimately did.

To posit that this consequence of the *Schwinn per se* language yields increased intrabrand competition misses the point. For the issue, surely, is not the mere enhancement of such "competition", but whether it is the type of competition which, as a matter of antitrust policy, ought to be preserved, particularly when the cost of so doing is injury to other forms of competition. We respectfully suggest that it is not, at least on a *per se* basis. To a not insubstantial degree, the commercial "value" attributable to established product lines is intangible and results from the joint efforts of manufacturers and dealers. Compare Demsetz, *Inconsistencies in Monopolistic Competition,* 80 J. Pol. Econ. 592, 595-6 (1972); Scherer, *supra,* at 327. This is particularly true in a selective or "spaced" distribution system such as Schwinn employed. While the antitrust laws properly recognize the value of "entrepreneurial choice", it is at best questionable whether any true competitive gains are realized by permitting dealers to

reap profits for a relatively short period by "creaming", or taking a "free ride", upon the prior efforts of manufacturers and other dealers to create product identification and good will. See, *e.g.*, Posner, *supra*. Although it is possible to conceive of short-run consumer benefits from such practices, it is almost invariably the case that these benefits, if such they be, endure no longer than the time required for the products in question to be stripped of their appeal. What is more, it is precisely those items which have acquired the greatest consumer desirability (and which thus offer the greatest potential for dealer profit) that are particularly subject to this type of "free ride" abuse.[49]

C

Schwinn's Per Se Language Is Not Compelled By Decisions Forbidding Vertical Price Maintenance.

Petitioners argue at length that the analytical principles applicable to the Schwinn and Sylvania practices are indistinguishable from those applicable to vertical price fixing. Hence, it is said, any decision placing respondent's locations practice in the rule of reason category would necessarily undercut price holdings from *Dr. Miles* forward. (See Pet. Br. 50-52.)

[19]The situation in Sacramento obviously presented the potential for an attempted "free ride" by Continental. See *supra*, at 10-11, 15 fn. 12. Whether that was, in fact, its motive is an issue which need not be resolved in the context of determining whether a *per se* rule properly applies to Sylvania's locations practice. It should be noted, however, that the "free ride" phenomenon need not depend—as Continental argues—upon the existence of super-normal profit-making by existing dealers. That will be the case only where interbrand competition is absent or weak, a situation which neither Schwinn nor Sylvania ever confronted.

It is, of course, true that antitrust scholars, such as Professors Bork and Posner, have suggested that vertical price maintenance may be pro-competitive in many instances. However, this Court has held in *Schwinn* and elsewhere that price and non-price restraints involve discrete antitrust considerations. Were it otherwise, there would have been no basis for the government's separate price claim in *Schwinn;* nor would there have been reason for this Court's extended non-price analysis in that case or in *White Motor* four years earlier. In fact, in the latter action, the District Court apparently accepted substantially the same "price" argument advanced by Continental here only to have this Court disapprove it on appeal. 372 U.S. 253 (1963), *rev'g,* 194 F. Supp. 562 (N.D. Ohio 1961).

Moreover, the distinction between price and territorial vertical restraints is sound in analysis as well as precedent. As Justice Brennan pointed out in his separate opinion in *White Motor,* restricting dealer discretion in the price area inhibits not only intrabrand competition but also the ability of dealers to respond to interbrand competitive conditions. See 372 U.S. at 268. By contrast, under vertical restraints affecting only territory, dealers remain entirely free to lower their prices to meet (or beat) the competition of other dealers.

Also, while non-price distribution restraints may be ancillary to a price maintenance system, that certainly will not be so in every case. Indeed, economic theory suggests that, in ordinary circumstances, a manufacturer will desire intense price competition among its dealers and a low overall price for its goods, thus maximizing demand. Compare, *e.g.*, Posner, *supra,* at 283.

Petitioners' attack also proves too much. While it is certainly true that both the Schwinn and Sylvania practices possess the potential to affect price, the same is true of any form of vertical restraint. Thus, the same charge could be levied with equal force against a system of exclusive distributors. See discussion *supra,* at 39-43. In short, the issue is not the mere potential for price impact but whether in a given case that potential has been realized—something that did *not* occur in either *Schwinn* or the instant case since in each the respective plaintiffs made *and lost* price-fixing claims in the District Court.[50]

D

The Rule of Reason is the Proper Standard For Evaluating Non-Price Vertical Restraints.

In any particular case the various observations noted above may be inapposite to the facts presented. But the reverse will equally be true. And that, we submit, is the point of this discussion and of our suggestion that *Schwinn* should be reconsidered. For *per se* rules are too blunt an instrument to be indiscriminately wielded except when it is clear from both economic theory and abundant practical experience that the consequences of the challenged practice are demonstrably and invariably "pernicious." That simply cannot be said of non-price vertical restraints. Compare, Note, 88 Harv. L. Rev., *supra* at 642; Hearings on H. R. 6684 Before the Subcommittee on Monopolies and Commercial Law of the House Judiciary

[50]Continental's "price" arguments are also beside the point of this case in that its practice was to sell Sylvania products at $50-$100 *above* suggested list. See *supra,* at 13.

Committee, 94th Cong. 2d Sess. (1976) (Statement of Richard Posner).

Indeed, for the reasons noted above, we believe that in a competitive market context a manufacturer's decision concerning the nature of its distribution system should ordinarily be regarded as presumptively lawful—much as exclusive distributorships are regarded under the law at present. Of course, to the extent that such a decision is implemented as part of an attempt to monopolize or is otherwise demonstrated to operate unreasonably, the treble damage sanction remains available.[51] Such unreasonableness, however, should not be presumed as the basis for a *per se* rule which invalidates practices which neither logic nor justice properly condemns.

III

THE TRIAL COURT ERRED IN REJECTING SYLVANIA'S "FAILING COMPANY" DEFENSE AND REFUSING TO INSTRUCT THE JURY WITH RESPECT THERETO.

The uncontradicted evidence establishes that prior to the adoption of its locations practice Sylvania was a "failing company" in the television business.[52] That evi-

[51]Also, manufacturers remain bound by any contractual obligations to continue to deal which they may have assumed as well as by implied covenants of good faith and fair dealing—not to mention by economic self-interest. A rational manufacturer will not lightly terminate a distributor or dealer who is returning substantial profits to him. This is all the more true where it is likely that the terminated dealer will immediately become an outlet for his competitors.

[52]*Supra,* at 5-6. As petitioners misrepresent the clear meaning of Mr. Steiner's testimony, we feel constrained to reemphasize that his testimony was that Sylvania "*would probably* go out of business" if its locations practice did not improve its market position. (R.T. 2543-2544. Emphasis added.)

dence would have permitted the jury to find that Sylvania's adoption of a locations practice was a reasonable and necessary means for enabling it to stay in that business rather than abandon it completely to larger competitors. Similarly, the evidence would have supported a finding that Sylvania's locations practice remained reasonable and necessary in 1965 in view of changing market shares and conditions. At the very least the evidence warranted an inquiry by the trier of fact into these areas.

The notion of economic necessity premised upon impending business failure as justification for conduct otherwise deemed anticompetitive is now firmly fixed in the jurisprudence of this Court. The doctrine originated in the field of mergers or acquisitions (*International Shoe Co. v. FTC,* 280 U.S. 291 (1930)) and has since been recognized by this Court frequently.[53] The *Schwinn* majority itself recognized that there could be exceptions to the *per se* rule of illegality in a case either of "a newcomer,

[53]See *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974); *United States v. Greater Buffalo Press*, 402 U.S. 549 (1971); *Citizen Publishing Co. v. United States*, 394 U.S. 131 (1969); *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962); *United States v. Diebold, Inc.*, 369 U.S. 654 (1962). See also *Granader v. Public Bank*, 417 F. 2d 75 (6th Cir. 1969), *cert. denied*, 397 U.S. 1065 (1970); *United States v. Maryland & Virginia Milk Producers Ass'n*, 167 F.Supp. 799 (D.D.C. 1958), *aff'd in part and rev'd in part on other grounds*, 362 U.S. 458 (1960); Hale and Hale, *Failing Firms and the Merger Provisions of the Antitrust Laws*, 52 Ky. L.J. 597 (1964); Comment, *An Updating of the "Failing Company" Doctrine in the Amended section 7 Setting*, 61 Mich. L.Rev. 566 (1963); Connor, *Section 7 of the Clayton Act: The Failing Company Myth*, 49 Geo. L.J. 84 (1960); Bork, *Merger and the Clayton Act*, 74 Harv. L.Rev. 226 (1960).

seeking to break into or stay in . . . business" or a "failing company." 388 U.S. at 374.[54]

Moreover, the doctrine is not limited to business entities whose every product or every division is failing, as petitioners imply (Pet. Br. 61-63). In these proceedings the Ninth Circuit thought it appropriate to emphasize

> ". . . that even if a manufacturer is prosperous in its whole operation, the failing company defense is applicable if the company is failing in the manufacture and distribution of one of its significant products. In *Schwinn* Mr. Justice Fortas wrote of the 'product market.' 388 U.S. at 382." (Pet. Cert. App. A. 54, fn. 41).

See also *United States v. Reed Roller Bit Co.*, 274 F. Supp. 573, 584 n. 1 (W.D. Okla. 1967) (failing company doctrine recognized as applicable to sale by prosperous parent company of an unprofitable subsidiary).

[54]Even where *per se* rules apply, the lower courts have recognized that such rules operate as a presumption which may be overcome by proof of business necessity comparable to that adduced by Sylvania. See, *e.g.*, *Fortner Enterprises, Inc. v. United States Steel Corp.*, 394 U.S. 495, 506 (1969) ("It may turn out that the arrangement involved here serves legitimate business purposes . . ."). See also *Joseph E. Seagram & Sons, Inc. v. Hawaiian Oke & Liquors, Ltd.*, 416 F.2d 71 (9th Cir. 1969), *cert. denied*, 396 U.S. 1062 (1970). As interpreted by the FTC Staff Report on Franchising following in the wake of *Schwinn:*

> "It appears that in *Schwinn* the court left enough leeway in its initial threshhold test of overall reasonableness of vertical arrangements to enable the manufacturer to justify such an arrangement by establishing that *it could not have* entered the market or *expanded its market share because of the impossibility of obtaining dealers willing to handle its products without some territorial protection*, and by showing its inability to finance an effective agency-consignment arrangement." *Franchising*, a Federal Trade Commission Staff Report on Legal Problems in Connection with Franchise Agreements. (Emphasis added.)

The failing company defense, as thus recognized, is grounded in both economic and common sense. As this Court first stated in *International Shoe Co. v. FTC, supra,* the doctrine permits practices which have "the effect of mitigating seriously injurious consequences otherwise probable . . ." 280 U.S. at 302. Congress and this Court have both recognized that the public interest is plainly served when a company is permitted to employ "restrictive" practices essential to its remaining a vital competitive factor in the market.[55]

Assessing whether a company was failing is a task for the trier of fact, *United States v. Diebold, Inc.,* 369 U.S. 654 (1962); *cf. Calnetics Corp. v. Volkswagen of America, Inc.,* 532 F.2d 674 (9th Cir. 1976), *cert. denied,* ..... U.S. ....., 45 U.S.L.W. 3340 (Nov. 9, 1976), and a trial court's refusal to submit the defense to the jury when, as here, the facts so warrant, is grounds for reversal.[56] Thus,

[55]*See Brown Shoe Co. v. United States,* 370 U.S. 294 (1962) for a discussion of congressional intent respecting the "failing company" defense.

[56]Continental concedes that the failing company defense involves a factual inquiry but argues that the evidence is all in its favor (Pet. Br. 61-64). This it does notwithstanding (1) Sylvania's disastrous market position which prompted adoption of its locations practice, (2) the alternative of failure or abandonment of television operations absent a new distribution policy, and (3) the ultimate pro-competitive effects of the locations practice—all summarized *supra,* at 5-7, 10-13. Continental's arguments might have merited this Court's consideration had the issue been presented to the jury and been resolved adversely to Sylvania; but they have no office to play with respect to the trial court's refusal to submit the question after deciding to apply the *Schwinn per se* rule. Continental's disparagement of Sylvania's proposed instruction is simply disingenuous (Pet. Br. 64). It is the trial court's duty to instruct—and to instruct properly—when the evidence so justifies. See *supra,* at 21 fn. 16. Here, the trial court simply declined to give any instruction, however couched.

even assuming that a *Schwinn per se* rule was applicable to Sylvania's locations practice, the trial court's refusal to accord Sylvania the benefit of the failing company defense by giving appropriate jury instructions thereunder was prejudicial error.

IV

IF A LOCATIONS PRACTICE BE HELD ILLEGAL PER SE UNDER SCHWINN, THAT RULING SHOULD NOT BE APPLIED RETROACTIVELY.

Were this Court to hold that *Schwinn* strikes down a locations practice as illegal *per se,* it would be singularly inequitable to apply that ruling retroactively to Sylvania. For in the 1962-1965 period, Sylvania had every reason to believe that its locations practice was subject to the rule of reason and lawful thereunder. To subject Sylvania now to treble damages on a *per se* theory for engaging in acts which were believed lawful when committed would not promote the policy of the antitrust laws. It would yield only a result as unanticipated as it is unjust.

For more than a decade this Court has recognized the inequity of imposing the treble damage remedy for acts which a defendant had no reasonable basis to believe indefensible under the antitrust laws at the time they were committed. Thus, in *Simpson v. Union Oil Co.,* 377 U.S. 13 (1964), this Court recognized the applicability of the nonretroactivity principle in treble damage suits where the equities would warrant only prospective appli-

cation of a newly announced rule.[57] Again, in *Hanover Shoe v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968), this Court reaffirmed the viability of the nonretroactivity principle in a case where there was a clear and fundamental change in the law.[58] Thus the nonretroactivity concept has emerged "as a commonsense and pragmatic response by the Court to a significant but surmountable conceptual difficulty," namely, that courts do make and change law and in the course of doing so "there is no need to disturb matters already settled, so long as those potentially affected by the new or changed rule are treated fairly and consistently. . . ." Beytagh, *Ten Years of Non-Retroactivity: A Critique and a Proposal*, 61 Va. L.Rev. 1557, 1563 (1975).

Sylvania submits that the equities of this case mandate the nonretroactive application of a broad *per se* rule based on the particular language of *Schwinn*. That *Schwinn* established a new principle of law of some dimension

[57]The principle was reiterated in *Simpson v. Union Oil Co.*, 396 U.S. 13 (1969), although this Court reversed the Ninth Circuit on the grounds that the principle should not be applied to the very litigant who succeeded in changing the law.

[58]Other courts have echoed these views. In *Lyons v Westinghouse Electric Corp.*, 235 F.Supp. 526 (S.D.N.Y. 1964), for example, the court held that *Simpson v. Union Oil Co., supra*, which held for the first time that one could be guilty of retail price fixing in consignment arrangements, should not be applied retroactively to parties who were not litigants in the *Simpson* case itself. The court explained:

> "To hold Westinghouse liable now for damages for making and carrying out a contract which was perfectly legal at the time it was made and carried out, would be manifestly unjust." 235 F.Supp. at 537.

can scarcely be doubted.[59] Under the law in effect prior to *Schwinn*, and particularly that in effect in the relevant period involved in this lawsuit (1962-1965), Sylvania reasonably could have assumed nothing other than that its locations practice—pursued by a nondominant manufacturer with a very minor share of the market—was lawful under the rule of reason. The only reported case directly involving such a practice, *Boro Hall v. General Motors Corp., supra*, expressly so held. The courts, also, had uniformly upheld the legality of analogous "exclusive dealing" agreements in situations where neither the manufacturer nor dealer dominated the market.

Prior to the decision in *Schwinn* the legality of territorial or customer restraints depended upon an analysis of their competitive purposes and effects and a finding that they unreasonably restrained competition in the marketplace. *White Motor Co. v. United States, supra*. *White Motor* was uniformly accepted as decreeing a "rule of reason" test for all vertical restraints until the split opinion in *Schwinn*. See, *e.g., Sandura Co. v. FTC*, 339 F.2d 847 (6th Cir. 1964); *Snap-On Tools Corp. v. FTC*, 321 F.2d 825 (7th Cir. 1963). Even the Government didn't expect to prevail in *Schwinn* on a *per se* theory. See

[59]Continental concedes as much, acknowledging that in *White Motor* "the Court left open whether or not a *per se* rule ought to govern. Four years later, after wide ranging argument, and over pointed dissent, the issue was decided in *Schwinn*." Continental argues, not that *Schwinn* left prior law unchanged, but rather that pre-*Schwinn* doctrine was insufficiently "clear and established" to warrant non-retroactive application of the new doctrine announced therein (Pet. Br. 65-68). In so arguing Continental has not only misstated pre-*Schwinn* law, but has focused its argument on a peripheral consideration, as our discussion *infra* at 74-75 makes plain.

supra, at 32. Thus to say that *Schwinn* represented a significant departure from the approach of earlier cases is scarcely an overstatement, as attested to by the fact that Justice Stewart's separate opinion, joined by Justice Harlan, describes the decision in *Schwinn* as "a radical change in the law." 388 U.S. at 389. Justice Stewart further stated:

> "Despite the Government's concession that the rule of reason applies to all aspects of Schwinn's distribution system, the Court nevertheless reaches out to adopt a potent per se rule. *No previous antitrust decision of this Court justifies its action.* Instead, it completely repudiates the only case in point, White Motor." 388 U.S. at 388-389. [Footnote omitted and emphasis added.][60]

To apply such a radical change in the law retroactively to a locations practice, we submit, would be grossly unfair.

Furthermore, the purpose of the doctrine announced in *Schwinn*—"the preservation and promotion of competi-

[60]In the proceedings below and again before this Court, petitioners argue that *Schwinn* merely paralleled prior decisions and a pattern of antitrust consent decrees (Pet. Br. 64-68). Although that position ignores the clear language of *White Motor* as well as *Schwinn* itself, it accurately reflects the misimpression of law that the District Court brought to this case. For, as the Ninth Circuit recognized (Pet. Cert. App. A. 14, fn. 10), in instructing the jury Justice Clark apparently mirrored his own dissenting comments in *White Motor* rather than the rule of reason that decision properly stands for. We respectfully take exception to the District Court's remark, quoted at Pet. Br. 68, that, prior to *Schwinn,* "the general understanding in the antitrust bar" was such that even a law student would have known that Sylvania's locations practice was violative of the antitrust laws. It suffices to observe that distinguished members of the antitrust bar continue to perceive a legally decisive difference between territorial restrictions of the kind involved in *Schwinn* or *White Motor* and Sylvania's locations practice. See *supra,* at 36 fn. 29.

tion", 388 U.S. at 375—would not be furthered by retroactive application of that decision. All that would result is an inequitable penalty on the one hand and an unjustifiable windfall gain on the other. As the Seventh Circuit explained in *Bendix Corp. v. Balax, Inc.,* 471 F.2d 149, 157 (7th Cir. 1972), *cert. denied,* 414 U.S. 819 (1973), wherein the retroactivity of *Lear, Inc. v. Adkins,* 395 U.S. 653 (1969), was at issue:

> "To award damages occurring prior to the decision of *Lear,* based upon the license restrictions voided on that date, would not enforce *Lear's* policy but would be purely punitive, a result not warranted where, as here, no fraud nor bad faith was shown to be involved." 471 F.2d at 157.

The facts of this case, and the equities they generate, readily satisfy the three-pronged test this Court has articulated for determining whether a change of law should be applied retroactively in a nonconstitutional, noncriminal case. In *Chevron Oil Co. v. Huson,* 404 U.S. 97, 106-107 (1971), this Court said:

> "First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, see, e.g., Hanover Shoe v United Shoe Machinery Corp., supra, at 496, or by deciding an issue of first impression whose resolution was not clearly foreshadowed, see, e.g., Allen v State Board of Elections, supra, at 572. Second, it has been stressed that 'we must . . . weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation.' Linkletter v Walker, supra, at 629.

> Finally, we have weighed the inequity imposed by retroactive application, for '[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the "injustice or hardship" by a holding of nonretroactivity.' Cipriano v City of Houma, supra, at 706."[61]

Chevron Oil's emphasis upon basic notions of equity and fairness is particularly apt where, as here, there has been a precedent-breaking decision in the context of the punitive treble damage remedy.

Chevron Oil also laid to rest any implication from this Court's language in *Hanover Shoe, supra,* 392 U.S. at 496, that retroactivity decisions should turn upon whether a party demonstrates reliance in fact upon prior doctrine.[62]

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[61]Many lower courts have subsequently invoked and applied this test when called upon to decide whether a decision should be applied nonretroactively in a civil case. See, *e.g., Matter of S/S Helena,* 529 F.2d 744, 748 (5th Cir. 1976); *Jimenez v. Weinberger,* 523 F.2d 689, 702-704 (7th Cir. 1975), *cert. denied,* ..... U.S. ..... (1976); *American Timber & Trading Co. v. First Nat'l Bank of Oregon,* 511 F.2d 980, 984-985 (9th Cir. 1973), *cert. denied,* 421 U.S. 921 (1975); *Bourns, Inc. v. Allen-Bradley Co.,* 480 F.2d 123, 129-131 (7th Cir.) (Pell, J., concurring and dissenting), *cert. denied,* 414 U.S. 1094 (1973); *Bendix Corp. v. Balax, Inc., supra,* 471 F.2d at 155-158; *United States v. Benitez Rexach,* 411 F.Supp. 1288, 1293-1294 (D.P.R. 1975); *Hambrick v. Royal Sonesta Hotel,* 403 F.Supp. 943, 945-946 (E.D.La. 1975); *Bush v. Wood Brothers Transfer, Inc.,* 398 F.Supp. 1030, 1032-1033 (S.D.Tex. 1975); *Bergstrom v. Kissinger,* 387 F.Supp. 794, 795-796 (D.D.C. 1974), *aff'd,* 530 F.2d 1093 (D.C.Cir. 1976).

[62]In light of *Chevron Oil,* petitioners' contention that nonretroactive application of *Schwinn* is precluded because Sylvania has purportedly failed to show "reliance" on an "overruled" "clearly declared judicial doctrine" (Pet. Br. 64-65), is plainly miscast. Similarly inapposite is Continental's assertion that nonretroactive application of *Schwinn* would deprive it of "the fruits of successful litigation." (Pet. Br. 69.) The principle Continental invokes is limited to those litigants who succeeded in changing the law and who, on equitable grounds, are accorded the rewards which flow from their success. *Simpson v. Union Oil Co., supra,* 396 U.S. 13; *Lyons v. Westinghouse Electric Corp., supra.* It does not extend to a litigant who, like Continental, fortuitously filed its complaint before the change in law was announced in litigation pursued by others.

This and other courts have long recognized that participants in the commercial world must arrange their affairs "in reliance on the stability of decision," *Monroe v. Pape,* 365 U.S. 167, 222 (1961) (separate opinion of Frankfurter, J.), with "predictability of as great certitude as possible . . ." *Bourns, Inc. v. Allen-Bradley Co., supra,* 480 F.2d at 130 (Pell, J., concurring in part and dissenting in part). Reliance is thus reasonably presumed. As Chief Justice Burger wrote in *Lemon v. Kurtzman,* 411 U.S. 192, 199 (1973), "statutory or even judge-made rules of law are hard facts on which people must rely in making decisions and in shaping their conduct."

This is not to say that the nonretroactive application of *Schwinn* would completely immunize Sylvania's practice. All that Sylvania seeks is that the issue of whether it should be liable for treble damages for a practice carried out in 1965 and before be adjudicated under the rule of reason applicable at that time, rather than under a *per se* rule which first appeared in 1967. The effect of employing the nonretroactivity principle in the case at bar would simply be that the validity of Sylvania's conduct would depend upon whether that conduct unreasonably restrained competition.

CONCLUSION

It is respectfully submitted that the judgment of the Court of Appeals be affirmed and that the action be remanded with directions to hold a new trial under the rule of reason limited to petitioners' claim that they were injured in their business or property by reason of Sylvania's alleged enforcement of its locations practice.

Dated, San Francisco, California,
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